

A PROCESS MODEL OF INTERNATIONALIZATION - NEW TIMES DEMANDS NEW PATTERNS

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Abstract

The U-model is one way of analyzing the process of internationalization. The primary aim of this paper is to explore in what way the model suits reality concerning Finnish SMEs. The paper also briefly examines the SMEs' "co-operation" concerning different activities, with different parties both in Finland and abroad as a base for further studies that will integrate the traditional process model of internationalization with the network approach.

1 INTRODUCTION

The internationalization process is a long and demanding process and it takes both resources and management models to succeed. Many small and medium sized enterprises (SMEs) have started an internationalization process, which has stopped after some time, because they have not committed more resources to their operations. Possible reasons for this could be a lack of resources and knowledge. Another reason could be that they lack distinctive management models of how to run the business on an international level. The export activities are often occasional and there is a lack of a holistic view of the relationship between internationalization, co-operation and growth.

The traditional view of internationalization is that it is based on economies of scale and large firms. Internationalization in small firms are more often combined with threats than with opportunities. Traditionally small firms are, however, often considered to be home-market oriented (Lindmark 1998). Earlier research has been concentrated on internationalization in large firms and therefore internationalization in SMEs is a relatively unexamined area (Coviello & Munro 1997; Holmlund & Kock 1998). Apparently there is a need for more research within this area.

2 POSITIONING OF THE STUDY

During the 20th century internationalization has been of great interest among researchers. Generally internationalization is considered to be a complex and multidimensional process. There are various approaches of describing internationalization. A short review of these approaches is presented in figure 1.

<i>Approaches</i>	<i>1) Process models</i>		<i>2) Eclectic models</i>	<i>3) The network approach</i>
<i>Research</i>	A)The U-model Aharoni 1966, Johanson & Wiedersheim-Paul 1975, Johanson & Vahlne 1977, Johanson & Mattsson 1988	B)I-models Rogers 1962 Bilkey & Tesar 1977 Czinkota & Johnston 1981 Czinkota 1987	Dunning 1988, 1993 Hill, Hwang & Kim 1990	Johanson & Mattsson 1984, 1988 Welch & Welch 1993 Welch, Welch, Wilkinson & Young 1996, 1998
<i>Size of firms</i>	large firms	all firms	large firms	large-/SMEs
<i>Assumptions of internationalization</i>	a cumulative process of increasing international knowledge and resource commitments, which is affected by incremental decisions	the learning process associated with an innovation or new idea	-rational decisionmaking within firms -environmental factors are important	-second-degree internationalization -subsidiaries' control over important resources - inward activities of importance

Figure 1: A review of internationalization models

2.1 Process models of internationalization

Welch and Luostarinen (1988) defines internationalization as follows: "... *the process of increasing involvement in international operations...*". Aharoni (1966) was the first to conduct a study from a more longitudinal view. Aharoni's work is important since it paved the way for other studies of the firm's internationalization process. His findings have been a source of inspiration for future research. Some years later the longitudinal approach was developed a stage further in studies of internationalization in Nordic firms. The original model is the so called *Uppsala-model* (the U-model) that was developed in the 70s by among others Johanson and Wiedersheim-Paul 1975 and Johanson and Vahlne 1977. The model contains different steps that describe the firms' level of internationalization. According to the model a firm often initiates its internationalization process by direct exporting to a foreign country. After some time the firm starts exporting with the help of independent representatives (agents) abroad. This is also called indirect exporting. The following stage is to develop sales subsidiaries in a foreign country. The fourth and last stage in the model is the establishment of a production/manufacturing facility abroad. (Johanson & Wiedersheim-Paul 1975; Johanson and Vahlne 1977) A basic assumption of the model is that one cycle of events

constitutes the input of the next. This indicates that the present state of internationalization is an important factor in explaining the direction of further internationalization.

The theory of the internationalization process is broadly accepted. Lately there has, though, been recognized a need for development of the original model as it was created in the 70s. On the first hand, when firms, for example large firms, have surplus resources, they can be expected to make larger internationalization steps. On the second hand there is the situation when market conditions are stable and homogeneous, it can happen that important market knowledge can be acquired in other ways than through experience. Thirdly, a firm may have considerable experience from markets that have similar characteristics and in a situation like this it may be possible to generalize this experience to the specific market. (Johanson & Vahlne 1993)

Another important aspect is the claim by several authors (Porter 1980; Lewitt 1983) that the world generally has moved towards homogenization. Lewitt (1983) claims that especially technology is the contributing factor to a more homogeneous business world. The development within the field of information technology has “made” the distances between countries smaller, and the communication flows faster.

The original model was developed as a result of a study of four Swedish firms. This could be seen as a fairly limited number of study objects. It is also difficult to get a clear picture of the different stages in the model. Other claims are that the model is too deterministic and that the empirical evidence is not clear enough. Turnbull (1987) has criticized the model by claiming that the choice of entry mode is independent of a firm’s previous experience in export markets. He cites some empirical studies, for example Turnbull and Valla (1986); which contradict the concepts of the Uppsala-model. The studies show that firms do not follow any particular and consistent pattern in their internationalization process. Firms may choose different entry modes and internationalization patterns in different countries. There is also a tendency of differences between industries.

2.2 Purpose

The aim of this paper is to explore the internationalization process of Finnish enterprises situated in the region of Ostrobothnia. The focus lies on whether they follow an internationalization process in accordance with the U-model, or whether the pattern is different and if so, in what way is it different. A secondary aim of the study is to get some understanding of the co-operation that each enterprise has with other parties, both in Finland and abroad. The empirical study in this paper will serve as a base for the direction and positioning of further studies.

2.3 Internationalization from a network perspective

According to the *network approach* (Johanson & Mattsson 1988) internationalization is seen as a process in which relationships are continuously established, developed, maintained and dissolved with the aim of achieving the objectives of the firm. Johanson and Mattsson (1988) have identified four stages of internationalization: the early starter, the late starter, the lonely international and the international among others. These are further illustrated in figure 2.

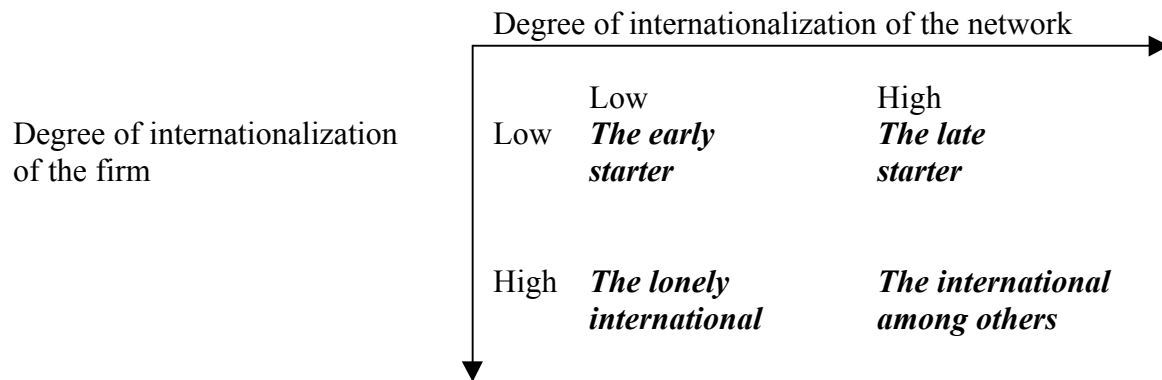


Figure 2: Internationalization and the network model

Source: Johanson & Mattsson 1988

The internationalization strategy of a firm is characterized by the need to 1) minimize the need for knowledge development, 2) minimize the need for adjustment and 3) exploit established network positions. For *an early starter* it can be problematic to fulfill the above named demands, since the firm is among the first to develop a network. Sometimes the costs might outweigh the advantages. If both the degree of internationalization of the network is low and the degree of internationalization of the firm is low, the firm can follow the traditional step-by-step model (the U-model) (Hertz & Mattsson 1994).

The biggest challenge for *the lonely international* is the co-ordination of the international activities. The firm might also face pressure as far as the adjustment of resources is concerned. The problems faced by *the late starter* differ from those of the early starter and the lonely international (Ahokangas 1998). The firm is to a large extent dependent on the other actors that already exist within the network. The other firms might try to hinder the firm's entrance into the internationalized market. The customers and/or suppliers may also "pull" the firm into the international network. *The international among others* operates within an internationalized network, in which differences between countries decrease over time. The utilization of external resources can be considered as the best option for the firm to expand internationally. It is therefore typical that for example mergers, joint ventures and alliances occur, which evidently will have an effect on the existing network.

Borch (1994) claims that strategic co-operation and alliances are sources of increased capacity of small firms as they struggle to overcome the problems of internationalization (for instance scarce resources).

Johanson and Vahlne (1993:51) write as follows:

An extension of the internationalization process model to take into account the network aspect should consequently make the concepts "commitment, knowledge, current activities and commitment decisions" as multilateral rather than unilateral as in the original model. That means that the process is also interorganizational and not just intraorganizational.

In general, the network perspective goes beyond the models of incremental internationalization. The network perspective of internationalization suggests that strategies made by the firm are influenced by a variety of network relationships. This means that relationships may drive, facilitate or inhibit a firm's internationalization. By cooperating with

its partners, a focal firm may also be influenced by its partners' partners (Ford 1998). The relationships may also influence the firm's choice of foreign market and entry mode. (Coviello & Munro 1997; Hertz & Mattsson 1994)

It is evident that a network approach to internationalization is a good starting point when examining the process of internationalization among SMEs. In order to create competitive advantages and survive, firms have to establish themselves within the existing network of the international market. There is also research (Karagozoglu & Lindell 1998) indicating that one of the greatest problems faced by SMEs is to find suitable partners abroad.

According to Johanson and Mattsson (1988) the internationalization of the firm begins with the fact that the internationalizing firm initially is engaged in a network which is primarily domestic. According to the network view, internationalization means that firms develop business relationships in networks in other countries. The idea is that the relationships of a firm can function as bridges to other networks. A firm which operates within international business relationships can use these relationships to get into networks in foreign countries. (Johansson and associates 1994)

3 METHOD

The empirical part of the study is based on a quantitative study of 65 enterprises in the region of Ostrobothnia, Finland. These enterprises were chosen from a list of the 70¹⁵¹ most exporting enterprises in the region. They are considered to be a suitable sample for the study, since they are expected to expand their operations internationally. A questionnaire was sent to the managing directors of the enterprises that represent different sectors of industry. Some enterprises were within manufacturing and others within service industry. The questionnaires were followed up by phonecalls. The total response rate was 44,6 percent, i.e. 29 questionnaires, which can be considered as a good response rate, since the survey was quite long and unstructured, which mean that the respondents had to write an own answer to many questions. The real response rate was 38,5 percent, i.e. 25 questionnaires, because we were unable to use four questionnaires as they were not filled in properly.

4 RESULT

4.1 The process of internationalization

Of the examined enterprises only one was within the service sector, while the others were within the manufacturing sector. Another interesting aspect is that only one of the questionnaires was answered and sent in by an enterprise within the electronic industry. The majority of the enterprises were within the so called base industries, for example the steel- and iron-industry. The amount of employees varied between 20 and 249, and this indicates that all of the examined enterprises can be considered as SMEs according to the suggestion by the European Commission (1996).

The average amount of turnover that consists of international purchases was 26 percent. The corresponding amount for exports was 64 percent. These findings indicate that generally the

¹⁵¹ The list was presented in a local management journal called "Coastline". Five enterprises were not analyzed, because they represented organizations within the education sector and therefore were not suitable for a study like this.

enterprizes tend to be more outward orientated than inward orientated. Another aspect that was examined is the reasons for internationalization. The majority of the enterprizes have mentioned the smallness of the homemarket as the major reason for internationalization. Other factors that were mentioned are: aquirement of knowledge, higher prices on the international market and possibilities for growth.

As far as the process of internationalization is concerned, the results of the study indicate that most of the enterprizes have started their process of internationalization in a country that geografically is situated nearby. The majority of the enterprizes, i.e. 16 enterprizes, started their internationalization in Sweden. The second most common country is Germany and then Norway. These are all countries that are geografically near located to Finland, and also have a lot of other similarities, for example the legal system and culture, with Finland. Tendencies like these have also been pointed out in earlier research (e.g. Holmlund & Kock 1998; Coviello & Munro 1999; Johanson & Vahlne 1999). The research has shown that companies usually start their process of internationalization in a country that have many similarities with the homemarket. According to Coviello and Munro (1999) companies improve their knowledge of foreign markets by starting with indirect exporting to similar markets. Over time, the companies get more experience and expand their business into more "psychically distant" markets. As the experience further increases the companies start sales operations abroad and offshore manufacturing.

The most common countries for the second step in the process of internationalization are Germany, Denmark, England and the Baltic countries. The third step was generally taken towards the Benelux countries, East- and Westeuropa and the Far East. One interesting aspect is that enterprizes that have international outward operations in areas of the United States of America and the Far East have not started their process of internationalization in these countries. In general the enterprizes have started their operations in these countries as the third or fourth step, after international operations in Europe. These findings indicate that the psychic distance tends to matter for the SMEs in Ostrobothnia, Finland.

Concerning the methods of internationalization from a process point of view this study shows results that are different from the original U-model as it was developed in the 70s (Johanson & Wiedersheim-Paul 1975; Johanson and Vahlne 1977). According to this study the *first step* towards a foreign market has most often, i.e. in 13 cases, been taken through an *agent* abroad, i.e. indirect exporting (stage two in the original U-model). The second most common establishment method is the development of a sales subsidiary (stage three in the original U-model) abroad. Ten firms started their internationalization process by establishing sales subsidiaries. Only four enterprizes started with direct exporting (stage one in the original U-model).

The results show that the *second step* in the process of internationalization most often, i.e. 11 cases, is taken through an *agent*, as in the first step. Establishment of sales subsidiaries comes on second place. Only two of the examined enterprizes use direct exporting at this phase. As far as the *third step* is concerned, both agents and sales subsidiaries are common establishment methods. Seven enterprizes used agent at this phase and six established a sales subsidiary. According to the original U-model the fourth step in the process of internationalization is manufacturing abroad. Surprisingly few enterprizes in this study manufacture abroad. Only two enterprizes had some kind of manufacturing abroad. The results show that the majority of the enterprizes have taken their *fourth step* through the establishment of a sales subsidiary abroad. What is interesting is that only 44 percent of the

enterprizes have taken a fourth step in their process of internationalization. This indicates that the majority of the enterprizes remained on stage three. The stages in the process of internationalization that emerged in this study are illustrated in figure three.

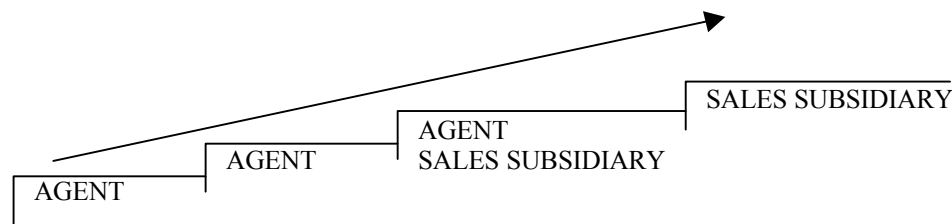


Figure 3: A process model of internationalization

We also asked the respondents what has helped them in the process of internationalization¹⁵². A majority of the firms consider good quality, good products, the personnell and own know-how as the major contributing factors. The corresponding result for factors that have had no importance are: international financial support and co-operation with competitors. This is an interesting finding, if we compare what is generally said about the importance of co-operation in the process of internationalization (see Borch 1994 for example).

It has been quite difficult in this study to get a clear picture of the internationalization from a network perspective¹⁵³. If we compare with the model developed by Johanson and Mattsson (1988) we can say that there seems to be a tendency that most enterprizes in the study belong to the late starters. The late starter has to face the risk that other firms may try to hinder entrance on a specific foreign market. This could perhaps to some extent explain the process model of internationalization of the SMEs in this study that seem to have stagnated in their process of internationalization. There are, though, some enterprizes that clearly can be considered as lonely internationals.

4.2 Co-operation

We examined the enterprizes' co-operation with different parties; customers, suppliers and competitors, both in Finland and abroad¹⁵⁴. Generally we can say that there is a tendency of co-operation with Finnish enterprizes in Finland and co-operation with foreign parties on foreign markets. This means that co-operation in Finland with foreign parties and abroad with Finnish parties is more rare. Another general finding is that co-operation with customers and suppliers is much more common than co-operation with competitors.

Concerning customers it is most common to co-operate within the fields of: product development, research and development and sales. The corresponding activities concerning suppliers are: product development, research and development, purchasing and

¹⁵² We measured this by asking the respondent to reflect about different factors (good quality, good products, international contacts, national contacts, national financial support, international financial support, export-organizations, co-operation with competitors, co-operation with suppliers, the personnell, own know-how and own patents/licences) and to circle to what extent the specific factor had contributed to the internationalization of the firm. The respondent could choose between the following alternatives: to a large extent, to some extent and not at all.

¹⁵³ One reason for this is because the network structure was not sufficiently examined in the study. We believe that it would be more suitable to use a more qualitative approach when examining network structures.

¹⁵⁴ The co-operation was specified to consider the following activities: product development, research and development, sales, market research, manufacturing, administration, purchasing, distribution, stockholding, service and finance.

manufacturing. It is hard to find a clear picture of the co-operation with competitors, because of the few answers (concerning all the activities, co-operation with competitors has been pointed out 14 times. The corresponding number for customers is 112 and for suppliers 129), but activities that have been most frequently pointed out are: purchasing, market research and manufacturing.

5 CONCLUSIONS

The results of the study indicate that the SMEs in the sample have not fully followed the U-model (Johanson & Wiedersheim-Paul 1975; Johanson and Vahlne 1977) of internationalization. They have started by going to countries close in culture to the home country, but the chosen operational mode has been agents in the beginning and still is. Consequently they seem to have stagnated in their internationalization processes. This result is in accordance with earlier studies (e.g. Holmlund & Kock 1998). The results, though, cannot be generalized because the number of respondents is limited. The reasons why they have stagnated may differ. Reasons among others, as we are dealing with SMEs, can be; (i) the entrepreneur wants to keep the power of the company in his own hands, (ii) they are not willing to commit more resources, (iii) they lack resources, i.e. human and knowledge, (iiii) they feel that they have enough problems already, or (iiii) the risk is perceived too high.

Another reason why the SMEs seem to have stagnated in their process of internationalization could be that most of them belong to the late starters according to the model developed by Johansson and Mattsson (1988). The late starters have to face the other firms that are already established on the international market. These firms might hinder the late starters to develop their operations on the international market, which could lead to a stagnation in the process of internationalization as far as the late starters are concerned.

In the next step of the research we will use a qualitative approach and conduct case studies to get a deeper understanding of the phenomenon of internationalization. Main focus will be to explore the reasons for the pattern of internationalization founded in this study and in what way co-operation between enterprises can enhance the process of internationalization. By co-operating with other parties, SMEs could have better possibilities in getting further in their internationalization. We believe that there is a need to more deeply integrate the process model of internationalization with the network approach to get a more holistic view of the phenomenon.

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