



The contribution of internalisation theory to international business: New realities and unanswered questions[☆]



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ABSTRACT

This paper sets out the importance of internalisation theory to international business research and practice. It examines the context against which the theory has been developed, the environmental conditions in which the multinational enterprise has evolved and the phenomena that the theory has explained. It also examines the challenge to the theory of “unanswered questions”. These include governance, location theory, dynamics, networked multinationals, innovation, entrepreneurship and the role of risk and uncertainty.

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1. Introduction

In examining the contribution of internalisation theory to international business, this article sets out not only to show the importance of the theory to research on international business but also the crucial interaction of the theory with international business practice. The theory is examined in terms of its context, its environment and the key phenomena it was intended to explain, and to predict. This piece contends that interaction with real world business phenomena has been a major feature of internalisation theorising and this has been a key strength, enhancing the power of the theory.

This paper interprets “context” to mean the social, political and economic conditions in which successive versions and revisions of the theory were set. “Environment” is taken to be the most important external (to the firm) conditions under which theorising about the multinational firm occurred. “Phenomena” are the key largely macro events, trends and circumstances that the theory was intended to explain. As these phenomena largely arose in the dynamic global business world, this article pays particular attention to the (two-way) interaction between theory and evolving global business practices.

The first part of the paper examines the ways in which internalisation theory has responded to the new realities of a changing global economy from the 1970s onwards. It does so by

examining what was written at the time to reflect changing realities using broad timespans of circa 1976, “the eighties”, “the nineties”, “the early 2000s” and 2015 to reflect key pieces by progenitors of the internalisation school¹ – see [Table 1](#).

The paper then goes on to pose some ‘unanswered questions’ although it cannot resist putting a question mark after this phrase and attempting to answer, at least partially, some of these questions.

2. Internalisation theory and the changing global economy

2.1. “Initial conditions” – the 1970s and before

The growth of the multinational enterprise as a dominant institution in the world economy was recognised following the end of the Second World War by political, social and academic attention to its growing salience. Significant theoretical and conceptual development was initiated by [Stephen Hymer’s 1960 thesis](#) (published [Hymer, 1976](#)) and the parallel pioneering work of [John Dunning \(1958\)](#) and [Raymond Vernon \(1966\)](#).

The overwhelming political reaction was suspicion and sometimes fear of the potential dominance of large firms that spanned national boundaries, and, it was surmised, national controls. This hostility to MNE was particularly in evidence in what were then

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¹ This paper takes a narrow view of internalisation theory, not directly addressing Williamson’s Transaction Cost Economics (TCE) agenda ([Williamson, 1981, 1996](#)), nor John Dunning’s Eclectic Paradigm ([Dunning, 1979, 2000](#)). The eclectic paradigm included internalisation as one of its key elements-with location and ownership (OLI), but did not directly contribute to internalisation theory per se.

Table 1
Internationalisation theory: context, environments and phenomena.

| | 1976 | The 1980s | The 1990s | The Early 2000s | 2015 |
|--|---|---|---|--|--|
| Context | Hostility to MNE | Indigenous Development | Strategies of MNE Entry and Development | How to attract FDI in Development | Plurality of Locations and Modes |
| Environments | Big Firms, Small Countries | Power to “host countries” | Best use of foreign resources | Global Value Chains Rise of China (BRICs) Competition for FDI | Worldwide Competition for activities |
| Phenomena | Unitary MNE ‘Western Hegemony’ | Attention to (capitalistic development) LDCs “Competitiveness” Global Commodity Chains World Trade in Goods and services – transfer pricing/internal trade Small(er) Firm Foreign Investment | Flexible MNE | Governance BRICS Externalisation and Offshoring New Locations “Globalisation” | World Trade in Tasks (activities) Internalisation of knowledge, Externalisation of Activities Non-equity Modes (UNCTAD WIR 2012) |
| Internalisation Theory: Key Publications | Future of the Multinational Enterprise (Buckley & Casson, 1976) | Country Competition JVs as “solution” Foreign Market servicing strategies The Entrepreneur (Casson, 1982) Vertical Integration/Intermediate Product Trade (Casson, 1985; Casson et al., 1986) Rugman (1981) Inside the multinationals Casson (1979) Alternatives to the MNE Theory of Cooperation (Buckley & Casson, 1988) Limits to Explanation (Buckley, 1988) “Competitiveness” (Buckley, Pass, & Prescott, 1988) Porter (1990) The Competitive Advantage of Nations. | Buckley and Casson Models of MNE (1998a) Knowledge Based Theories (Buckley & Carter, 1999) | Emerging Market MNEs EMNEs and the basis of their Competitiveness Global Factory (Buckley & Ghauri, 2004) Global Systems View Buckley and Hashai (2004) Real options (Kogut & Kulatilaka, 2001) COFDI explained (Buckley, Clegg, et al., 2007) Buckley and Hashai (2014) Question the theoretical necessity for ‘ownership advantages’ | Market for Market Transactions (Liesch et al., 2012) Hennart (2009) JIBS ‘Bundling’ Buckley and Casson (2011) Marketing and the Multinational. |

termed LDCs (Less Developed Countries) and by international organisations attempting to defend the interests of “small countries” against “large firms”. Particularly vehement in this respect was UNCTAD which had concerns about the exclusive control of key technologies (felt essential for development) by MNEs (UNCTAD, 2014). The changing attitude of UNCTAD towards MNEs (Transnational Corporations (TNCs) in UN-speak) is a case study in itself on changing attitudes (influenced by theory) towards MNEs (Buckley, 2010; UNCTAD, 2014).

At this stage MNEs were seen as unitary, monolithic companies. The standard MNE was Western (Japanese MNEs were included in this), privately owned, manufacturing, largely uninational in ownership, finance and culture, and capitalistic. Expanding this stereotypical view took time, and a theory that transcended these artificial constraints.

2.2. The 1980s

Internalisation theory was not new. Its progenitor, Ronald Coase, published the seminal piece ‘The nature of the firm’ in 1937, but the ideas had their origin in his undergraduate work considerably earlier. Oliver Williamson (1975) developed his ‘markets and hierarchies’ approach – building on foundations from the Carnegie School, almost simultaneously with Buckley and Casson’s (1976) application of the Coasean approach to MNEs. Earlier work had included McManus (1972) and it was quickly followed by the similar approaches of Hennart (1982), Rugman (1981) and Dunning (1979).

Internalisation theory cast the MNE in a different light to that shed by Hymer’s monopolistic competition approach (see also

Caves, 1971, 1974, 1980). Buckley and Casson (1976) showed that internalisation had both positive and negative welfare affects – perfecting markets versus concentrating power but, crucially, that the key factor in the growth of the MNE was not market power (although that may be a consequence in certain circumstances) but innovation. The shift to the dynamic innovatory capability of internal markets and the notion that foreign direct investment (FDI) was the firm’s internal substitute for the external diffusion of knowledge (inhibited by the market imperfections for knowledge and the problem of “buyer uncertainty”) (Buckley & Casson, 1976, pp. 38–39) transformed the understanding of MNEs and the appropriate policy prescriptions. It is interesting that the policy aspect of the *Future of the Multinational Enterprise* has been under examined, compared to the explanation of MNE growth, now adopted as a foundation of international business theory.

Internalisation theory opened the artificial boundaries of understanding of the MNE – small firms, non-Western firms, non-manufacturing firms and crucially non-hierarchical, non-monolithic firms not necessarily vertically and horizontally integrated, came within the ambit of the theory. Alternatives to the MNE (Casson, 1979) were explored – such as the licencing option (wider than just technology transfer in internalisation theory). Critical to this understanding was the approach to international trade in intermediate goods and services. Much of this trade took place within firms but across countries – giving an added complexity to standard trade theory and to business strategy because this trade took place at internal ‘transfer prices’ rather than between separate agents. The policy development and management issues of this are profound and remain to this day.

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