

A NOTE ON SEQUENTIAL MODELS OF INTERNATIONALIZATION

Eleanor Westney

Multinational companies are made, not born. How a company becomes a multinational is an issue that has drawn a number of researchers to look at the patterns of change over time in a firm's international operations. Two models in particular have been found useful by managers, policy-makers, and academics: Ray Vernon's Product Life Cycle (PLC) theory, and the learning model developed by researchers in Sweden (Johanson & Vahlne, 1977).

The Product Life Cycle Theory

In 1966, Ray Vernon developed a model built on the internationalization patterns of U.S. firms - which dominated overwhelmingly the ranks of MNCs at the time. In the mid-1960s, per capita income in the U.S. was still much higher than in any other major market (it was twice the level of Western Europe, for example), and the U.S. had relatively high labour costs. Vernon postulated that U.S. manufacturers would likely focus on innovations for the high-income consumers of their home market and/or labour-saving products, and that they would be highly likely to produce their new products in their U.S. factories, even if they owned factories abroad in lower-cost locations. Vernon reasoned that with new products, for which the optimum design was still unclear and the price sensitivity of customers relatively low, the home base was "a location in which communication between the markets and the executives directly concerned with the new product is swift and easy, and in which a wide variety of potential types of input that might be needed by the production units are easily come by" (Vernon, 1966: 105-6).

The innovating company, therefore, was likely to produce a new product first in its U.S. home market, for which the product had been originally designed. Over time, the product matured: a dominant design became accepted and production processes stabilized. Meantime, an export market would develop for the product in those markets where certain high-end customers welcomed the innovation and are willing to pay a premium for it. Over time, foreign demand would grow, as foreign markets advanced economically, and exports increased. Eventually, the firm would consider setting up manufacturing in its larger foreign markets. Vernon postulated that most managers are "myopic" -- unlikely to incur the costs and uncertainties of moving production outside their home country unless pushed into doing so by a "triggering event" that threatens their export markets, such as the emergence of local competitors trying to move in on the market created in their country by the firm's exports, or the threat of tariffs.

Once established in the larger markets, the offshore production facilities would serve local markets with local production, substituting for exports. The market would expand, since the price of the product would be reduced by local production (lower labour costs, the elimination of transport costs). Over time, this lower price would encourage the growth of markets in the less developed countries, which might well be served not from the home country factories but from the secondary factories. And as the product becomes standardized, the firm might well set up production in the most rapidly growing less developed countries, where economic growth has created new markets. Eventually, the home

country itself is served by products manufactured offshore, either by the firm's own subsidiaries offshore, which take advantage of highly standardized production processes and low labour costs to reduce prices, or by local competitors in the "follower" countries that can emulate the by-now standardized production processes and take advantage of established and increasingly price-sensitive markets in the earlier-developing markets. The trade patterns predicted by the PLC are illustrated in Figure 1 (attached).

While the PLC theory came to be widely accepted as a theory of the migration of industries across locations over time, Vernon himself recognized that its validity as a model of the evolution of the MNC was challenged by the changes in U.S. MNCs in the ensuing decade. By the late 1970s, many of America's leading MNCs had well-established networks of production around the world, and were increasingly likely to introduce new products simultaneously in several markets, rather than beginning at home and rolling out the product internationally over time. One reason for doing so was the closing of the income and labour cost gaps between the U.S. and the other developed countries, especially those in Europe; another reason was the speed at which increasingly capable local companies could emulate (often through reverse engineering) new products (Vernon, 1979). Vernon himself wrote a critique of his own model in 1979, suggesting that it was much less general than he had posited more than a decade earlier. But he suggested that it might well still apply to companies just beginning their international expansion, and for firms whose products involved high levels of experimentation and uncertainty early in the initial production runs. He suggested that it would also apply to firms in the rapidly industrializing countries such as Mexico, Brazil, and Korea, whose innovations, tailored to their home markets, might well find their most promising international markets in "the other developing countries that were lagging a bit behind them in the industrialized pecking order" (Vernon 1979: 266).

2. The Learning Model

Sweden has long been home both to a surprisingly large number of multinational companies and to a number of researchers in international management. Studies of the internationalization process of Swedish firms found that "they often develop their international operations in small steps, rather than by making large foreign production investments at single points in time" (Johanson & Vahlne, 1977: 24). The process was incremental in two ways: in terms of the level of involvement (the mode), and in terms of locations.

Several studies of Swedish firms produced the same finding: in each country they entered, they tended to begin their internationalization by exporting through an agent. The next step was establishing a sales subsidiary, and eventually, in some cases, establishing a manufacturing subsidiary. The researchers also found a progression in terms of what they called the "psychic distance" of locations, involving the degree of difference from the home country in terms of language, education, business practices, culture, and industrial development. Swedish firms often set up their first foreign subsidiaries in neighbouring Nordic countries, expanded into Northern Europe, and eventually ventured farther afield. Studies of MNCs from other home bases found similar patterns: U.S. firms tended, for example, to set up their first foreign subsidiary in neighbouring Canada. But physical distance was often less important a factor

than what the Swedish researchers called “psychic distance”: British firms in the 1930s, for example, were more likely to set up a subsidiary in India or Australia than in France.

Researchers attributed these patterns of gradual, incremental expansion to an increase of knowledge and what we would now call “capabilities”. Increases in interaction with and integration into a given market environment, through links with customers and growing familiarity with the business system, reduced uncertainty levels and increased the confidence of the managers of the firm in their ability to operate within those environments. Foreign experience in similar environments increased the company’s capabilities for operating across more challenging borders, and increased the company’s willingness to venture farther afield.

REFERENCES

Johanson, J., & Vahlne, J.-E. (1977). The Internationalization Process of the Firm -- A Model of Knowledge Development and Increasing Foreign Market Commitments. Journal of International Business Studies, 8, 23-32.

Vernon, R. (1966). International Investment and International Trade in the Product Cycle. Quarterly Journal of Economics, 80, 190-207.

Vernon, R. (1979). The Product Cycle Hypothesis in a New International Environment. Oxford Bulletin of Economics and Statistics, 41, 255-267.