Chapter 6

Important International Management Theories

International Management requires theories to explain why and how companies internationalise and how international companies carry out their activities, e.g., how they coordinate their international activities or where they locate their different subsidiaries. The same theories can also be used to predict companies' behaviour. This Chapter presents the most relevant International Management Theories.

Introduction

International Investment as Capital Movement

Until the 1960s, foreign direct investment by companies was mainly seen as movement of international capital and explained by investment theories and portfolio considerations. The main argument for international investment was that it occurs due to different rates of return between countries. This view has obvious deficiencies: It does not correctly explain the empirically observable patterns of direct investment, e.g. the two-way direct investment flows between some major countries; it does not explain why companies from the same country and even within the same industry differed in their internationalisation behaviour and it does not consider differences between the motives for international purchase of a few foreign stocks bonds (i.e. portfolio investments) and for substantial equity ownership by domestic companies in foreign companies (i.e. foreign direct investment, FDI).

Hymer's Theory of Monopolistic Advantages

During the 1960s, the perception of the multinational firm changed and the first theory of the international firm was developed. This was the work of Steven Hymer, who undertook the development of a more comprehensive theory on FDI and MNCs, emphasizing the control companies get over foreign activities by means of FDI (see Forsgren 2008, pp. 15-29, for a detailed description of Hymer's contribution). He argued that under perfect competition, all companies would have access to similar resources and technology. Since in this case local firms in a foreign market would have knowledge advantages, little foreign direct investment would occur because incumbents would have a competitive advantage over new entrants. Thus, to overcome this *liability of foreignness*, companies wanting to successfully expand abroad must have some kind of competitive advantage to compensate for their knowledge disadvantage. This competitive advantage leads to a *monopolistic advantage*, which represents a deviation from pure competition (Forsgren 2008, p. 16). Examples of such monopolistic advantages include product

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D. Morschett, H. Schramm-Klein, J. Zentes, *Strategic International Management*, DOI 10.1007/978-3-658-07884-3_6

differentiation, marketing skills, patents, technological expertise, economies of scale, etc. In Hymer's perspective, some level of *market imperfection* is at the root of MNCs' development. He argues (Kutschker/Schmid 2011, pp. 414-415; Forsgren 2008, pp. 20-23)

- that it may be beneficial for a company to exploit its monopolistic advantages beyond the own domestic market and
- that it may be beneficial for a company to do so by means of vertical integration, mainly because that gives the company higher control over foreign activities and helps to avoid competition, thus contributing to monopolistic power.

Transaction Cost Theory and Internalisation Theory

In Hymer's view, the MNC creates its benefit by maintaining a monopolistic advantage and avoiding or reducing competition. Other authors criticise this view and argue that Hymer does not sufficiently explain how company advantages are generated in the first place (i.e., that Hymer focused only on the "unfair" exploitation across borders instead of the welfare-enhancing creation of advantages) and that he ignores the fact that MNCs are potentially better at carrying out cross-border activities internally than independent companies.

Over the last decades, the dominant theories to explain internationalisation and related concepts, e.g. the choice of foreign operation mode, have been the *transaction cost approach* (TCA) (Williamson 1985) and the closely related *internalisation theory* (Buckley/Casson 1976). These approaches argue that companies internationalise in a way that minimises the cost of cross-border transactions. They point to the fact that it may be more efficient to internalise markets across borders, e.g., because a joint coordination of different activities in different countries may incur less cost ("transaction costs") than using market mechanisms between countries.

Transaction Costs

Transaction costs refer to s*earch and information costs,* i.e., costs incurred in determining that the required good is available on the market, who has the lowest price, etc.; *bargaining costs,* i.e., costs required to come to an acceptable agreement with the other party to the transaction, drawing up an appropriate contract, etc., and *monitoring and enforcement costs* to ensure the other party sticks to the terms of the contract, and taking appropriate action if they do not. For example, monitoring costs might include measuring output (e.g. quality control in the factory of a supplier). If conditions change, contracts might have to be adjusted which incurs *adjustment costs*.

The two basic assumptions of the transaction cost approach are:

- *Bounded rationality*, i.e., actors intend to act rationally but are only capable of doing so in a limited way, partly because they have incomplete information and partly because they have limited processing capacity.
- *Opportunistic behaviour*, i.e., business partners are expected to use the incompleteness of contracts and changing circumstances for their own self-interest and only adhere to the contract if they are monitored.

Imperfect Markets

If markets function well, with a large number of potential business partners, competition ensures efficient results. In these cases, an MNC will favour low control modes. Business partners can be replaced easily and this threat protects the companies from opportunistic behaviour. In other cases, markets may fail. This may be the case for different types of transactions (Malhotra/Agarwal/Ulgado 2004, p. 4):

- *imperfect markets for goods* created by brand names, marketing capabilities, product differentiation
- *imperfect markets for intermediate goods*, such as knowledge, whereby it is assumed that the cross-border transfer of knowledge is less efficient among separate companies than within one MNC
- *imperfect markets for production factors* that may be created by exclusive procurement capabilities, particular management expertise or certain technologies
- *imperfect competition through economies of scale* that lead to cost advantages for internalisation.

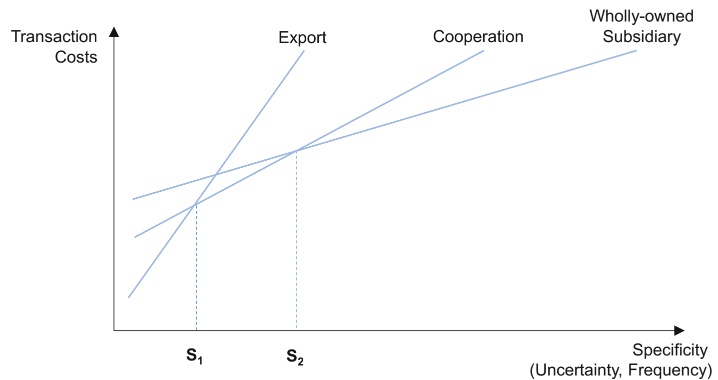
However, market imperfections are mainly caused by three transaction characteristics:

Asset Specificity, Uncertainty, and Frequency

First, *asset specificity*, the degree to which an asset loses its value when put to an alternative use, may create a situation where an actor who has carried out specific investments runs the risk of being exploited by their partner. In this case, market transactions between independent actors might not offer sufficient protection for the business partners. Thus, the MNC might decide to carry out the transaction internally, i.e. with a wholly-owned subsidiary. Similarly, *uncertainty* may lead to market imperfections (Welch/Benito/Petersen 2007, pp. 24-25). If all future eventualities were known in advance, contract parties could plan ahead and develop comprehensive contracts. The stronger the uncertainty (e.g. changes in the external environment), the more likely it is that contracts are incomplete and have to be adjusted. These renegotiations can lead to high transaction costs. Again, the necessary flexibility to adapt to changing situations may be better granted with internalised operation modes. Third, the *frequency of transactions* plays a role. Setting up a wholly-owned foreign subsidiary is often linked to

relatively high fixed costs, but the subsequent variable costs are usually lower than in the case of cooperative or market modes. Thus, with an increased number of transactions, the relative costs of a wholly-owned subsidiary are reduced.

Figure 6.1 *Transaction Cost Reasoning for Different Modes of Internationalisation*



Source: Adapted from Welch/Benito/Petersen 2007, p. 26.

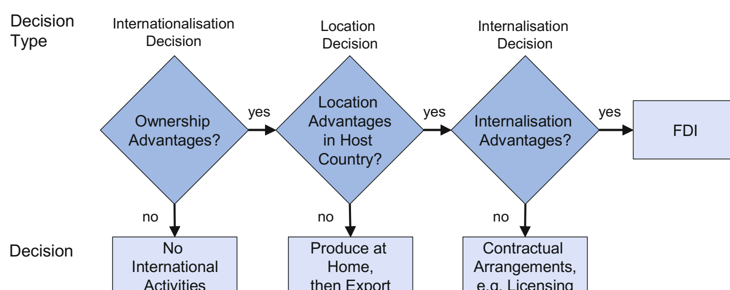
To summarise, the transaction cost approach compares the costs of internalisation of external markets with the costs of market transactions and cooperation (see Figure 6.1). Under certain circumstances markets are imperfect, and companies are forced to internalise transactions to compensate.

Dunning's OLI Paradigm

Because the existing approaches (e.g. the internalisation theory or the theory of monopolistic advantages) alone cannot fully explain the choice of foreign operation mode, John Dunning developed a comprehensive approach, the so-called *Eclectic Paradigm*, which aims to offer a general framework to determine which operation mode is the most appropriate.

Figure 6.2

The OLI Decision Process for Foreign Operation Modes



Source: Adapted from Sudarsanam 2003, p. 201; Welch/Benito/Petersen 2007, p. 31.

It specifies a set of three *conditions* that must prevail simultaneously to stimulate FDI from a company (Rugman/Collinson 2012, pp. 67-70; Dunning/Lundan 2008, pp. 96-108):

- *Ownership-specific advantages (O)*: The firm must possess some unique competitive advantages (*firm-specific advantages*, FSA) that outweigh the disadvantages of competing with local firms in their home market (*liability of foreignness*). Often, ownership-specific advantages take the form of the possession of intangible assets, which (at least temporarily) are specific to the firm. This follows the general argument by Hymer.
- *Location-specific advantages* (*L*): If foreign direct investment is to take place, it must be more profitable for the company to undertake the activity in the foreign country than in the home country. Otherwise foreign markets would be served by other operation modes. Location-specific advantages (or *country-specific advantages*, CSAs) can include, for example, labour costs, an efficient and skilled labour force, tariffs, transport costs or natural resources.
- *Internalisation advantages (I)*: Companies that possess specific advantages can either exploit them themselves (*internalise* them) or sell the advantage to other companies. The internalisation choice can be explained by *internalisation theory*, as pointed out above.

Whether foreign direct investment is favourable depends on which types of advantage prevail. To undertake internationalisation via wholly-owned subsidiary, all three types of benefits, O, L and I, must be present. This case

is illustrated in Figure 6.2, along with other situations that lead to different decisions about operation modes.

Resource-Based View

While the TCA focuses on transactions and analyses whether these are better carried out within the firm or between firms, the *resource-based view* (RBV) considers the firm as a *bundle of resources* (e.g. Wernerfelt 1984; Barney 1991).

Many previous approaches (e.g. the Industrial Organisation Approach) assumed that firms within an industry are generally similar in terms of strategically relevant resources and that any heterogeneity that may develop is short-lived because resources are highly mobile or even tradable. Instead, the RBV assumes (Barney 1991, p. 101):

- Firms within an industry may be heterogeneous with respect to the strategic resources they control.
- Resources may not be perfectly mobile across firms.
- Therefore, heterogeneity may be long-lasting.

Physical Capital, Human Capital, and Organisational Capital

Resources are broadly defined as "those (tangible and intangible) assets which are tied semipermanently to the firm" (Wernerfelt 1984, p. 172) or, more precisely, as "all assets, capabilities, organizational processes, firm attributes, information, knowledge, etc., controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness" (Barney 1991, p. 101). Barney categorises them into *physical capital resources* (such as technology, geographic location, access to raw materials), *human capital resources* (employee experience, judgement, intelligence and insight) and *organisational capital resources* (formal structures, informal relationships among groups within a firm, coordinating systems, etc.). To be the basis for a *sustained* competitive advantage, resources have to fulfil a number of criteria which have been extensively discussed over recent decades (Dierickx/Cool 1989; Barney 1991):

- They must be *valuable.*
- They must be *rare.*
- They must be *imperfectly imitable* (and they must be imperfectly or not tradable).
- There must be no strategically equivalent substitutes that are valuable but not rare or not imperfectly imitable.

Reasons for Imperfect Imitability

Resources may be imperfect imitable or non-tradable due to *path dependency* (i.e., the availability of the resource is dependent on the unique history of the company, e.g. personal customer relationships or a strong brand), *causal ambiguity* (i.e., the link between specific resources and the performance of the company is not clear) or *social complexity* (e.g., if the resource lies in interpersonal relationships within the company). Resources may also be tied so closely into the *resource bundle* of a company and only exert their full impact in combination with these other resources that it is not possible for another company to acquire or create them separately. These are mainly intangible assets, such as knowledge or organisational capabilities, and can create long-term success.

Strategic Questions

There are many strategic questions that can be analysed from the perspective of the RBV. The core question is how a company should exploit its resource base to maximise its profit, which includes the question of whether the company should exploit the resources nationally or internationally. In the latter case, one has to examine the value of the resources in a foreign country and the question of how to transfer the resources there optimally. Under the RBV, a company can also investigate the question of whether its own resources (e.g. a superior technology) must be complemented with the resources of another company in a foreign market (e.g. market knowledge or a distribution network) to optimally exploit the own resources. In this case, though, the company must consider whether its own resources are endangered by cooperation, e.g. by knowledge dissemination. Furthermore, if complementary resources in a foreign country are needed, the RBV allows the company to examine whether these are better accessed via cooperation or via the acquisition of the foreign company that controls them. Ultimately, under the RBV, internationalisation may not only be a means to exploit the given resource base but also to enhance it, e.g. by tapping into foreign knowledge.

FSA/CSA-Framework

In the terminology of another strategic concept of the international firm, the so-called *FSA/CSA-framework* (e.g. Rugman/Collinson 2012, pp. 49-52), there are two dimensions of advantages that an MNC must consider, each with a different relevance for different companies or industries:

- *Firm-specific advantages (FSA)* are strengths specific to a firm, a result of contributions that can be made by its personnel, technology, and/or equipment.
- *Country-specific advantages (CSA)* are strengths or benefits specific to a country that can result from its competitive environment, its labour

force, its natural resources, its industrial clusters, etc. Porter's diamond can be used to investigate CSAs (see Chapter 8).

FSAs and CSAs as a Matrix

Combining those two dimensions in a matrix, a company can investigate several issues. If the CSAs of the home country are dominant and FSAs rather weak, economic theories argue that comparative advantages of a country (or the location within an industrial cluster) will lead to exports – regardless of the specific characteristics of the company. If FSAs are strong and CSAs are weak, the focus of the international strategy is on exploiting the company's resources, without much influence from the location. Furthermore, FSAs need to be identified as either *location-bound*, i.e., only create their full value in a specific location (e.g., due to a technology that perfectly fits a locally specific demand) or *non-location-bound*. Only *non-location-bound* FSAs can be fully used for exploitation in foreign countries. Location-boundedness can occur for firm-specific assets in the home country, but also for subsidiary-specific assets in a specific host country. In the latter case, the FSA cannot contribute to the strategy of other subsidiaries. However, FSAs and CSAs frequently both exert a strong influence, in which case a company has an incentive to operate across borders, coordinate its resources across borders and needs to *combine the FSA of the company with the CSA of the host country* (and, maybe, the CSA of the home country) to be successful (Rugman/Verbeke/Nguyen 2011, pp. 766-768). In fact, it is this combination of FSAs with CSAs in different locations that is the challenge of a true MNC.

Rugman (2010) argues that the FSA/CSA-framework can also be reconciled with Dunning's Eclectic Paradigm and that the Eclectic Paradigm can be easily transformed into the FSA/CSA-matrix, making this framework a very general analytical tool for MNC strategy.

Dynamic Theories of Internationalisation

Internationalisation is not a static phenomenon but a dynamic process. Companies change their configuration over time, enter into new countries, and/or change their operation mode. While the theories above allow an analysis at any given point in time, they do not explicitly consider changes over time. Some International Management facilitates this, however, for example the older stages models more recent born global approaches.

Stages Models of Internationalisation

Internationalisation Process Model

The stages models of internationalisation are rooted in the *behavioural theory* of the firm. These models, of which the internationalisation process model (*IP model*, also called "*Uppsala model*") by Johanson/Vahlne (1977) is the best known, propose an association between the knowledge of the decision makers in the company and the level of resource commitment in a foreign market. The core assumption is that companies with low market knowledge about a specific foreign market prefer a low commitment in this market. Once in the market, the company accumulates experiential knowledge and this leads to the willingness to commit additional resources. In the so-called *establishment chain*, the model proposes that foreign operation modes in a specific foreign country are switched along a certain path:

- no international activities
- export activities via agents
- export activities via the company's own sales subsidiaries
- establishment of production subsidiaries in the foreign country.

Psychic Distance Chain

In addition, the IP model suggests that companies often select foreign markets based on the psychic distance to that market and that internationalisation often occurs along a *psychic distance chain*, with psychologically close markets being entered before more distant countries.

In general, the common assumptions of all stages models are (Swoboda 2002, pp. 72-73):

- Internationalisation is a slow and gradual process.
- The process of internationalisation is not the result of long-term strategic planning, but of incremental decisions.
- Internationalisation is an adaptive process, and with time, resource commitment in the foreign market and changes in the management of the foreign organisational unit will occur.
- Internationalisation is a process occurring in stages, characterised by different rates of change and unsteady development.
- During internationalisation, companies accumulate experiential knowledge which facilitates foreign activities and further internationalisation.

Overall, the stages models explain foreign operation modes mainly through the country-specific knowledge of a company that determines the perceived

uncertainty and, thus, the willingness of the company to invest resources in that country.

While the stages models are highly plausible, criticism has emerged over the years. First, the models omit that management has a *strategic choice* and the operation mode decision is not only determined by a single influence factor. In particular, external influence factors (like host country conditions) are neglected. Second, the models over-simplify a complex process and certain operation modes – in particular cooperative modes – are not considered. Cooperation (and acquisitions) offers the possibility of gaining knowledge without the MNC having long-term experience of its own in the host country. Finally, MNCs often leap over certain stages in the establishment chain (*leap frogging*). Still, for many companies, the stages models of internationalisation offer a good general explanation of their observed behaviour.

Born Globals

In the last two decades, researchers have increasingly observed a "new" phenomenon, namely companies that internationalise immediately after their foundation (Oviatt/McDougall 1994; Knight/Cavusgil 1996). This, obviously, has challenged the patterns proposed by the *IP model*. Companies, mainly small companies from the IT sector, biotechnology or other high-tech-oriented industries, have been increasingly seen to take up international activities (mainly exports) very early after their creation, enter multiple countries at the same time, enter very distant markets and achieve a high percentage of their sales outside the domestic market right from their inception. This phenomenon has been labelled "International New Ventures", "International Entrepreneurs", "Innate Exporters", or "Global Start-ups", but the most frequently used term is "Born Globals"

Definitions

Born Globals are "business organisations that, from inception, seek to derive significant competitive advantage from the use of resources and the sale of outputs in multiple countries" (Oviatt/McDougall 1994, p. 49). More concretely, another early source defines born globals as companies that "have internationalised within 3 years of inception and have generated at least 25 per cent of their sales from export" (Knight/Cavusgil 1996, p. 12). Thus, the two main definition criteria are:

- a short period between inception and first internationalisation
- a high level of internationalisation.

Both definition criteria – 3 years as duration from inception to internationalisation and 25% of foreign sales – have been criticised and modified by other authors. For example, it is argued that 25% may be high from the perspective

of US authors but that for many European companies from small home markets, this threshold is too low for a useful characterisation. Thus, other scholars use periods from between two and six years to characterise "from inception" and foreign sales from 25% up to 76% to characterise "high level of internationalisation". Sometimes, the geographic scope of the internationalisation is added, demanding a certain number of countries or a certain number of cultural clusters (Gabrielsson/Kirpalani 2004; Holtbrügge/Enßlinger 2004).

Explanations

Several arguments have been proposed to explain why born globals can successfully adopt an internationalisation strategy that differs from the traditional models (Holtbrügge/Enßlinger 2004, pp. 374-375; Gabrielsson/Kirpalani 2004):

- In the IP model, only the company (as an organisation) is able to gather international experience. In born global firms, however, the founder or the first management team as individuals often have international experience from previous jobs and therefore have the necessary knowledge of foreign markets and international activities.
- In the IP model, companies are considered to start with a domestic mindset and then slowly become aware of international market opportunities. Born global firms often have a global vision prior to their foundation as part of their strategy. This can be based on characteristics of the entrepreneurs or the specific industry.
- In the IP model, market knowledge can only be built from personal experience. Born global firms, however, are often integrated into formal networks, e.g. in strategic alliances with distribution partners or MNCs with subsidiaries in different countries. Such MNCs can act as system integrators and provide born globals with market access. Entrepreneurial teams can also be embedded in informal networks with former customer relationships (from previous jobs) or with private contacts that help to provide knowledge on markets around the world.
- Born globals often focus on *niche markets* where the potential in a single country is too small to survive; they therefore have to exploit the market potential in multiple countries.
- Born globals often have a unique technology and/or an innovative product or service or a superior design; thus, they follow a strategy of product differentiation. This may give them a *monopolistic advantage* which helps them to overcome the liability of foreignness in less familiar countries. Furthermore, in the industries in which born globals are most frequently observed demand in different markets is not very heterogene-

ous. Therefore, a product adaptation strategy is not necessary, and familiarity with the foreign country may be less relevant.

Selected Theories to Explain the Relationship between Headquarters and Subsidiaries

Information Processing Approach

The information processing approach from Egelhoff (1991) considers the *MNC* as an information processing system. Information processing refers to the gathering of data, the transformation of data into information, the communication and diffusion of information within the company and the storage of said information. Coordination requires consideration of the information processing requirements and capacities required.

Uncertainty as a Lack of Information

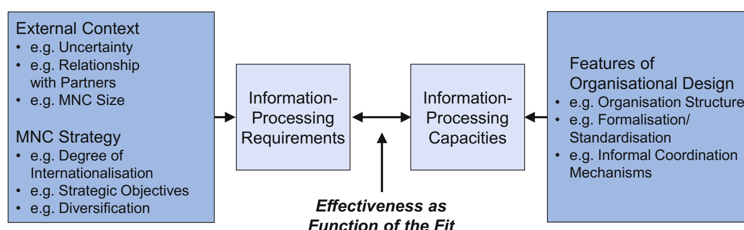
This approach assumes that different companies have different requirements for their information processing, partly based on the uncertainty of tasks. This *uncertainty* is defined as the difference between the amount of information necessary to perform a specific task and the information that is already available in the organisational unit. Internal and external information flows are used to reduce uncertainty (Egelhoff 1991, p. 343). Strong influences on uncertainty are the size of the MNC, the company's growth and the diversification of the company. Other external factors, like the technological dynamics of the industry, or internal factors, such as the degree of internationalisation, also affect the level of uncertainty (Wolf/Egelhoff 2001, pp. 121-122).

Different Types of Information

Different *qualities of information* to be processed stem from a distinction between *primarily strategic* or *primarily tactical* information, between routine and nonroutine information processing and between *sequential* and *reciprocal* information flows (Egelhoff 1991, pp. 350-353). These require different communication channels.

The Information Processing Approach

Figure 6.3



Source: Adapted from Egelhoff 1991, p. 345; Wolf/Egelhoff 2001, p. 122.

Different features of the organisational design, including coordination mechanisms, have different information processing capacities. The core argument of the information processing approach is that companies have to achieve a good *fit* or alignment between their information processing capacity and their specific information processing requirements (see Figure 6.3). Based on this approach, it can be argued that (Egelhoff 1991, p. 344; Wolf/Egelhoff 2001, p. 120):

- If information processing is routine and simple, *rules* and *programmes* (i.e. formalisation and standardisation) are sufficient to overcome the low uncertainty of the decision situation. For example, subsidiaries' reporting systems can be designed to match HQ's standards to ensure compatibility. These *standard reports* can eliminate the need for other forms of HQ-subsidiary communication.
- With increasing uncertainty, flexible and rapid decisions must be taken closer to the local host environment. *Planning*, including goal-setting, allows for more decisions to be made at lower levels in the organisation, provided they comply with the plan.
- If uncertainty increases further, the organisation's information processing capacity must be further enhanced, including coordination processes based on *vertical information systems* and *central departments*. *Informal communication* flows must be added to manage the increased uncertainty.
- With very high complexity, HQ might have problems processing all the necessary information. Thus, the use of *lateral relations* allows more information processing to be decentralised to disburden the limited information processing capacity at the higher levels of the organisation. Direct contact between executives, e.g. through project teams, linking pins, etc.,

enables effective information processing throughout the whole organisation (Egelhoff 1991, pp. 343-344).

Agency Theory

Agency theory (also called *principal-agent theory*) deals with *delegation relationships* in which a principal delegates certain tasks and decisions to an agent on the basis of an explicit or implicit contract. The actions taken by the agent influence the welfare of the principal. Contracts between the principal and the agent are always incomplete due to *limited information*, unpredictability of future situations and the (prohibitively) high cost of complete contracts. Furthermore, the principal-agent theory argues that usually there is *information asymmetry* in favour of the agent. Before closing a contract, the principal is not able to identify fully the capabilities and characteristics of the potential agent (*hidden characteristics*) and this might lead to a poor selection (*adverse selection*) (Richter/Furubotn 2003, pp. 218-219). More seriously (and more relevant for the case of MNCs), after the contract has been closed, the principal cannot completely observe the behaviour of his agent (*hidden action*) and the result of the delegation is also influenced by external conditions that the principal also cannot fully observe (*hidden information*) (Elschen 1991, p. 1004; Woratschek/Roth 2005, p. 152).

Risk of Opportunistic Behaviour

All this leaves room for *opportunistic behaviour* on the part of the agent. Agency theory assumes that the agent intends to maximise his individual utility and that the objectives (and the risk preferences) of principal and agent may diverge. Thus, conflicts of interest may emerge. With the assumption of *moral hazard*, it is assumed that the agent will even carry out actions that influence the welfare of the principal negatively if it enhances his own benefit.

Subsidiary as Agent of the HQ

Transferring this consideration to the HQ-subsidiary relationship, the HQ cannot make all decisions itself since it does not have the necessary information and resources. When delegating decisions and actions to the subsidiary, however, HQ must remember that the interests of the foreign subsidiary might diverge from its own. Principal-agent theory attempts to suggest mechanisms for information, incentive and control (*governance mechanisms*) that align the interests of the subsidiary with those of HQ, i.e., mechanisms that motivate the subsidiary to contribute to the overall objectives of the MNC (Nohria/Ghoshal 1994). A simple example is the possibility for a subsidiary to re-invest its profits locally instead transferring them to HQ.

Usually the HQ cannot observe and control all the actions a subsidiary carries out and the performance of the subsidiary is influenced by many aspects beyond the control of subsidiary management (*hidden information*). Thus,

controlling the outcome is also not sufficient to evaluate the subsidiary management completely, and in many cases, e.g. knowledge generation or innovation in the subsidiary, performance is not readily measured. Here, *normative integration* is seen as effective for establishing close relationships between the subsidiary and the HQ to reduce the propensity to behave opportunistically and influence the subsidiary to contribute to the overall company benefit "voluntarily" without explicit *performance measurement* (Gupta/Govindarajan 2000).

Expatriates Sometimes Better Agents

Using *expatriates* as an informal coordination mechanism can make sense from an agency perspective (O'Donnell 2000). Expatriates are more likely to act on behalf of the HQ than nationals from the host country, because an expatriate's career is more strongly linked to the HQ's evaluation of his performance, and the expatriate often identifies himself more strongly with the HQ than with the local subsidiary, since he or she was socialised in the HQ.

Market Elements as Coordination Mechanisms

On the other hand, the listed mechanisms all carry a cost (*agency costs*) and the costs of potentially opportunistic behaviour and the cost of control have to be balanced when deciding on the use of a coordination mechanism. Hierarchical coordination can be replaced to some extent by *market elements*. With externalisation, i.e., outsourcing activities to external partners, or "quasi externalisation", i.e., using market principles between organisational units within the company, market prices replace hierarchical authority. Considering agency theory, this is particularly appropriate when information asymmetry is strong, e.g., if the socio-cultural distance between home country and host country is high (Woratschek/Roth 2005, pp. 153-154).

Resource Dependence Theory

Resource dependence theory (RDT) is an *environmental interaction approach* (Pfeffer/Salancik 1978; Drees/Heugens 2013). The core idea is that companies need to exchange resources with their environment and they need certain resources from external sources to survive. This creates dependencies from other organisations and thus a risk for the company. RDT highlights the situations in which resource dependency is strong and the relevance of the resources to company survival is high. It suggests strategies to minimise the risk to resource supply.

Subsidiaries with Access to Critical Resources

From an MNC's perspective, both relationships between different companies and relationships between different organisational units within the MNC can be considered from an RDT perspective. Subsidiaries are often strongly dependent on resources from the HQ, which facilitates coordination. However, subsidiaries may be able to obtain resources that are difficult to access for other actors, including HQ, which affects the potential for central coordi-

nation within the MNC and sometimes diminishes the possibility of enforcing strategy conforming behaviour at the subsidiary (Andersson/Forsgren 1996, p. 488). From this perspective, the different levels of access to resources that have different relevancies for the MNC can be a key determinant for the internal relationships within the MNC (Pfeffer 1981; Nohria/Ghoshal 1997, p. 95). A subsidiary's *internal power* increases with the relevance of its resources for the MNC's performance, as substitutability of the resource decreases and with the uniqueness of the access to the resource by this specific subsidiary.

Powerful Subsidiaries Resist Strong Centralisation

Thus, resource dependency can be a source of conflict within the MNC. With increasing dependence on resources from the subsidiary, it becomes more difficult to enforce top-down decisions (Doz/Prahalad 1981; Nohria/Ghoshal 1997, pp. 96-97). On the other hand, limiting the autonomy of the subsidiary might reduce the effectiveness of the MNC network, because this might reduce the subsidiary's access to the strategic resource. In this situation, decision centralisation has to be replaced by other mechanisms. *Normative integration* can facilitate the negotiation process between parent company and foreign subsidiary (Nohria/Ghoshal 1997, pp. 100-101).

Contingency Approach and Configurational Approach

As an overarching theoretical approach, the contingency approach emphasises that there is no universally optimal management decision (e.g., no universally valid answer to how multinational a company should be, what the best organisational structure is, what the best foreign operation mode is and no universally optimal set of coordination mechanisms), but organisational decisions should be differentiated according to the characteristics of the external environment in which the organisation acts (Lawrence/Lorsch 1967; Thompson 1967; Kieser 2002, p. 169).

"It All Depends"

For example, the optimal foreign operation mode and coordination method is situational. The argument that these decisions strongly depend on the specific context follows directly from viewing organisations as *open systems* that have to interact with their external environment (Kieser/Walgenbach 2003, p. 215). Contingencies whose influences have been investigated include, *inter alia*, company size, the dynamics of the technological and market conditions and the uncertainty of the environment.

Strategic Choice Instead of Deterministic Relationship

However, one criticism of the contingency approach is the *quasi-mechanistic relationship* between the situation and the conduct of organisations. This implies a deterministic perspective, while in practice companies have a *strategic choice* (Child 1972) about how to act within their MNC as a reaction to different external situations. However, the general assumption of the contin-

gency approach, that the effectiveness and efficiency of coordination mechanisms (and other organisational variables) are influenced by the external environment and there is no universally best solution but rather situation-specific differences, is widely accepted. For example, it is argued that the complexity of a firm's coordination process must match the complexity of its environment (Ghoshal/Nohria 1993, p. 23).

Internal and External Fit

While the contingency approach focuses mainly on the relation between context and company, the *configurational approach* adds that the internal consistency between the organisational variables also has a strong influence on the efficiency of the organisation (Khandwalla 1973, p. 493). The *gestalt* of the organisation is more than the sum of its parts, and the configurational approach argues that an organisation is effective if the *consistency* or *fit* between organisational variables (like the coordination instruments) and between internal variables and the external environment is strong (Mintzberg 1981, p. 107). The configurational approach postulates that a comparatively low number of *typical constellations* of organisational variables exist that represent the majority of all combinations of organisational characteristics existing in practice (Miller/Friesen 1984). With regard to coordination, this implies that an isolated use and analysis of each coordination instrument is insufficient, but that the combination of coordination instruments applied is crucial for success.

Conclusion and Outlook

To understand and predict the internationalisation behaviour of companies, scholars have developed numerous theories within International Management. These theories take different perspectives on the MNC and help highlight specific characteristics that may influence company decisions. For example, transaction cost theory highlights the role of asset specificity for company decisions, while the resource-based view emphasizes resource characteristics and the optimal exploitation and creation of resources.

Depending on which company decision is analysed, different theories can be applied. Often it may be useful to combine several theories. When doing this, however, it is important to investigate the theories' assumptions to ensure they are compatible.

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