Knowledge-based Theories of Internationalization: Implication in Central and Eastern Europe

SONIA FERENCIKOVA, sr.

School of Management, Bratislava, Slovakia

SONIA FERENCIKOVA, jr.

Wirtschaftsuniversitaet Wien/School of Management, Bratislava, Slovakia

Abstract: The article tries to analyze two of the major internationalization theories (Uppsala model of internationalization, network-based model of internationalization) that take the knowledge aspect into the account. This is the platform that will help to explain the internationalization patterns of the Slovak firms in the future research. The theories can help to understand the triggers and motives behind the internationalization, competitive strategy, competitive advantage, know-how and innovation creation, and strategy implementation. The authors focus on the analysis of the theories and their implementation in Central and Eastern Europe including Slovakia. They conclude that both theories are fully applicable to the Slovak companies: the first one especially in the case of unexperienced companies lacking knowledge of the foreign markets. The second one could be applied in internationalization of majority of the Slovak companies, especially in the case when the companies owe some very specific knowledge and the network helps them to commercialize it abroad.

Keywords: theories of internationalization, Uppsala model, network-based model, Central and Eastern Europe

1 Introduction

The paper analyses and summarizes two major firm-level internationalization theories that take the knowledge aspect into account and points out their main research findings. Typically, the commonly cited theories are based on the internationalization patterns of firms emerging from advanced economies, like the US or Western Europe. With this respect and in the search for potential differences, each theory is followed by its implications for CEE firms. A few selected internationalization studies with a CEE focus are mentioned as well. These implications and studies try to describe the internationalization processes of firms emerging from the CEE region with the help of major internationalization theories. In some cases, authors must develop completely new research perspectives to explain the very specific local environments. Nonetheless, it is important to understand the following internationalization theories in order to test the applicability on internationalization patterns of Slovak firms, as there could be differences. The paper is based on the pioneering work of Ferencikova and Schuh (2012) and on the detailed analysis provided by Ferencikova, jr. (2014).

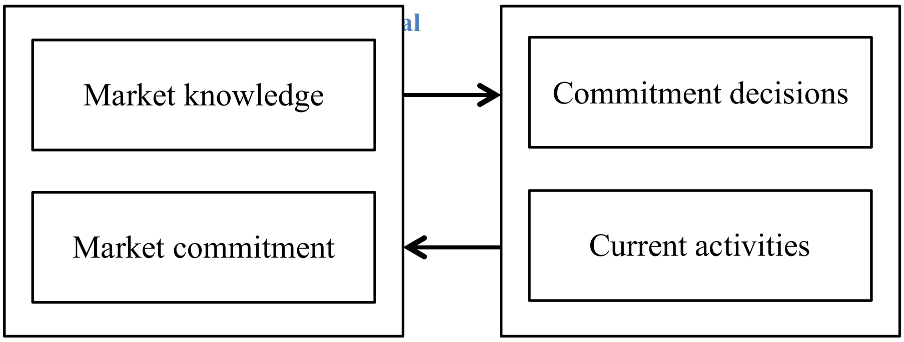
2 Uppsala model

Named after the University of Uppsala and developed by Johanson and Vahlne in 1977, this model is based on empirical observations of Swedish manufacturing firms. It describes firm-level internationalization as a process of incremental adjustments to changing environments, driven by experiential knowledge and learning (Johanson & Vahlne, 1977). The foundation of this dynamic model dates back to 1966, when Swedish economist S. Carlson analyzed a firm's foreign decision process (Pignatti, 2009). The core concept of his pioneering research concludes that lack of knowledge in doing business in a foreign market represents a significant obstacle for firms which have the intention to internationalize (Carlson, 1966) .

As observed in Swedish and some US manufacturing firms, the Uppsala model introduces a new dimension of internationalization- the pattern of the *establishment chain*. Johanson and Vahlne believe that internationalization should occur in multiple stages in order to successfully increase firms' commitments in foreign markets (Johanson & Wiedersheim-Paul, 1975). In most cases, firms start by exporting to foreign markets via independent representatives, develop sales subsidiaries later and eventually, begin production abroad (Johanson & Vahlne, 1977).

The model considers two aspects to explain the internationalization process of firms: state and change aspects (Johanson & Vahlne, 1977). While state aspects are represented by the market knowledge and market commitment of resources to foreign markets, change aspects are focused on the decisions to commit resources and the performance of business activities (Johanson & Vahlne, 1977). The Uppsala model mechanism is described in Figure 1.

Figure 1: Uppsala model - Original



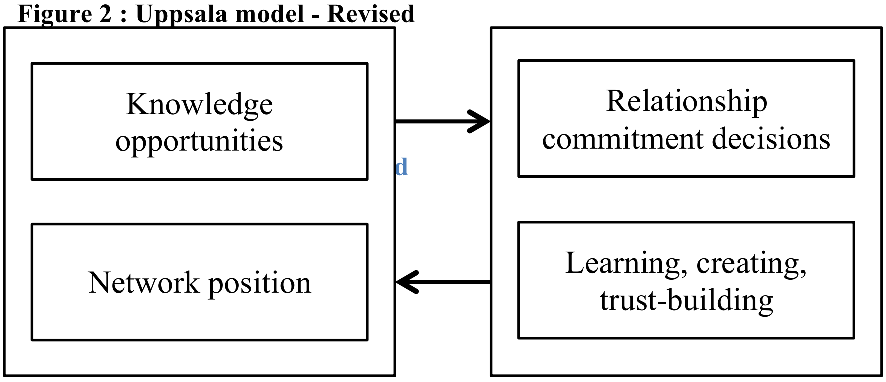
Source: Johanson & Vahlne, 1977

The fundamental focus is paid to the aspect of knowledge and learning, and the explanation how firms learn to gain knowledge throughout their international operations. According to Johanson & Vahlne (1977), the most efficient knowledge lies in the firm's own operations. Unlike the objective knowledge, which can be taught, the model believes in experiential knowledge, which cannot be easily acquired, and thus relies on the lifelong experiences of individuals. It is assumed that this knowledge and experience not only helps to analyze problems, influence the decisions to commit resources, and generate business opportunities, but also evaluates the market environment prior to performing business activities abroad. With this respect, the lack of experiential knowledge at specific stages of the internationalization process in a new market explains why firms pursue a gradual, step by step, process of internationalization (Johanson & Vahlne, 1977).

Besides the aspect of knowledge and learning, special attention is paid to the aspect of *psychic distance* as well. Typically, the stronger the language, cultural or environmental differences are, the greater the psychic distance is. Johanson & Vahlne (1977) believe that firms choose psychically close markets for expanding first in order to reduce possible risks and market uncertainty.

Due to the recent changes in business environments and theoretical advances made in the process of firm-level internationalization, the Uppsala model was revised in 2009 offering new insights into the internationalization process. Firstly, it claims that firms operate in markets defined by networks of relationships, rather than being parts of independent webs of suppliers and customers (Johanson & Vahlne, 2009). With this respect, "insidership" in close networks is necessary for firm's successful internationalization, while "outsidership" from such networks represents a significant obstacle in the process. Outsidership from a particular network can additionally cause a greater uncertainty than the psychic distance alone (Cassia & Baronchelli, 2008). Secondly, such networks of relationships foster knowledge creation, trust and commitment building for firms. Johanson & Vahlne (2009) therefore, emphasize the importance of networks as the key influencing factor for the firm-level internationalization. The revised model, as presented in Figure 2, puts more emphasis on opportunities. They are assumed to be the most important element linked to knowledge that drives the process of internationalization (Johanson & Vahlne, 2009). The authors also believe that the business network concept along with great opportunities can explain why some firms deviate from the originally proposed establishment chain and why some firms, mainly small new ventures, internationalize very rapidly (Johanson & Vahlne, 2009).

Figure 2 : Uppsala model - Revised



Even though the model is still considered up-to-date and used as theoretical base for related research, it is still criticized for the following reasons: Firstly, the conclusions are based on observations of only four Swedish manufacturing firms and therefore, do not have the sufficient explanatory power. Secondly, the pre-described internationalization process does not fully explain the rapid internationalization of some firms, or why some firms result in skipping the intermediate stages of the establishment chain (Pignatti, 2009). Lastly, the psychic distance proposed in the model does not take legal and competitive environments into consideration and thus, is not the only significant factor that influences firm's selection of foreign markets. Size, value and opportunities of the potential markets are also being considered (Pignatti, 2009).

2.1 Uppsala model and its implications on CEE countries

The situations of the CEE firms have changed significantly after the fall of communism and the transition to market economy at the beginning of the 1990's. Before 1989, the firms had very limited knowledge and exporting was possible only through very few foreign-trade institutions. If some of the biggest local players had access to the foreign markets, they usually focused on the Eastern Block, hence the COMECON countries (Federal Research Division, 2010). However, the beginning of the 90's meant several unexpected challenges for local CEE firms. Lack of foreign-market knowledge, know-how in operations and inadequate foreign language capabilities forced local firms to concentrate their foreign activities on neighboring countries, primarily. The political history of the CEE region supports the idea of psychic distance as well. The division of Czechoslovakia and Yugoslavia for example, initiated a big trade concentration among the succession states (Ferencikova & Schuh, 2012). After all, close historical ties, cultural, language and economic similarities of the countries must not be neglected. Aside from the aspect of psychic distance, the pattern of the establishment chain of the Uppsala model was typically used by the local firms; mostly by the classical industries, such as agriculture, which entered neighboring markets first, established manufacturing facilities later and eventually, started manufacturing products and services abroad (Ferencikova & Schuh, 2012).

Multiple studies on firm-level internationalization with the focus on the CEE region confirm the patterns of the *establishment chain* and *psychic distance* introduced in the Uppsala model:

1. The study of **Jaklič and Svetličič** (2003) examines recent growth of multinational firms emerging from Czech Republic, Estonia, Hungary, Poland and Slovenia. The main findings of this research show that firms internationalize primarily to neighboring countries, which can be explained by the aspect of psychic distance and historical ties, although some globally active firms were identified as well (Jaklič & Svetličič, 2003). Additionally, the study underlines the significance of both, firms' past experience and ambitious plans, as they experienced positive effects from the outward foreign direct investment.

2. The study of **Mockaitis, Vaiginiene, & Giedraitis** (2006) examines the internationalization patterns of Lithuanian manufacturing firms. The main objective is to examine the foreign market entry decisions of firms through the analysis of their size, age, knowledge base, risk aversion and commitment toward the internationalization process (Mockaitis, Vaiginiene, & Giedraitis, 2006). The study states that the degree of internationalization is positively related to a firm's age and size (Mockaitis, Vaiginiene, & Giedraitis, 2006). Unlike small firms which tend to depend on intermediaries, large firms typically have more resources to seek potential foreign partners. Additionally, young firms usually suffer from insufficient experience, network connections and knowledge, which relates to the Uppsala model and the incremental process of internationalization, gradual knowledge and experience acquisition (Johanson & Vahlne, 1977). This study concludes, that the observed firms operate in an uncertain environment without proactively seeking for opportunities and therefore, no clear patterns to describe the process of internationalization are found (Mockaitis, Vaiginiene, & Giedraitis, 2006).

3. The study of **Vissak, Ibeh & Paliwoda** (2007) examines the internationalization processes of four Baltic firms established during 1993-1999. The main aim of this qualitative analysis is to test the applicability of the major internationalization theories on selected firms, as well as to analyze the impact of the EU accession on the their internationalization (Vissak, Ibeh, & Paliwoda, 2007). The findings support the significance of the resource-based view when analyzing the firm-level internationalization process, yet still incorporate the significance of the Uppsala model perspectives. With this respect, this study supports the following two conclusions: All examined firms support the aspect of psychic distance by focusing on the neighboring markets first, as well as the establishment of a chain pattern by supporting the importance of the lower commitment mode of internationalization at a firm's early stages of the process (Vissak, Ibeh, & Paliwoda, 2007).

4. The study of **Ferencikova** (2014) examines examines internationalization process of 10 Slovak companies and concludes that in some cases the Uppsala model can be applied on her sample studied. She names the main reasons for that what was the lack of knowledge and experience from the foreign markets, and therefore the tendency to enter the neighboring countries first. It was also influenced by the division of Czechoslovakia that led to the sudden institutionalization of the Slovak companies in the neighboring Czech markets if they wanted to preserve their market position there.

3 The network-based theory of internationalization

As described in the previous section, the network view is a theory stream discussing the importance of business networks for firm-level internationalization (Johanson & Vahlne, 2009). Business networks represent sets of interlinked relationships between two and more actors who control business activities and resources (Forsgren & Johanson, 1992). These actors include individual firms, customers, suppliers, agents, competitors, and occasionally even governments and universities (Chetty S., 1994). Multiple studies analyze how firms use their relationships within networks to improve their performance by sharing knowledge and skills with the other actors (Chetty & Blankenburg Holm, 2000).

In the words of Johanson and Vahlne (2009), being part of business networks is necessary for a firm's successful internationalization, while being an outsider represents a significant obstacle in the process. Similarly to the Uppsala model, the network view believes that firms can gain relevant knowledge about a specific market (network) only when being a part if it (Forsgren & Johanson, 1992). With this respect, it is important for firms to find out whom the main actors in the foreign market are, what resources do they control and what activities do they specialize in, before they begin to internationalize. The network view believes that answering these questions is crucial for a firm's success, prior to their foreign market entry (Forsgren & Johanson, 1992).

Swedish firms and their strong industrial structure represent a great example to show the importance of long-lasting network relationships (Andersson, 2002). The Swedish economy is composed of multiple large firms and several small firms. Typically, the smaller firms are suppliers to these strong and large players, which are highly internationalized. Being a supplier to such big players enables smaller firms to access their networks, build relationships, trust, commitment and share knowledge and experience easily. Sweden has, therefore, an internationalized industry that perfectly reflects the network view (Andersson, 2002).

Besides Sweden, empirical studies on firms in New Zealand demonstrate the significance of business networks as well. The study of manufacturing firms in New Zealand by Chetty & Blankenburg Holm (2000) indicates that a firm's internationalization process is influenced by the internationalization of other actors within the business networks. The firms do not only benefit from resources shared within the network, but also use the networks to enter foreign markets. The study also emphasizes the difficulties non-internationalized firms face when trying to become a part of already existing tight networks. The authors conclude that being part of a business network has strategic importance for firms, as they are exposed to new opportunities (Chetty & Blankenburg Holm, 2000).

However, being part of such interlinked business networks represents challenges for some firms as well. Each activity within a network is, to a certain degree, dependent on the performance of other actors and the focus of their activities. As a result, differences in hierarchical levels or functional roles among the firms can significantly influence the pursued business strategies within the network. In extreme cases, the strongest players focus mainly on promoting their own interests (Forsgren & Johanson, 1992). Nonetheless, the network view believes that cooperation is more efficient than competition for the development of individual firms (Andersson, 2002). Such cooperation among the actors is beneficial, as it creates highly competitive firms.

3.1 The network-based theory and its implications on CEE countries

Typically, business networks and relationships represent many advantages for local CEE firms. Firstly, similarly to other firms, CEE firms enjoy favorable factor conditions for their internationalization, including specialized knowledge, know-how, experience sharing and access to resources. Secondly, and especially after the fall of communism and due to the weak legal framework, firms were experiencing difficulties in securing the necessary financing. As a result, many firms tried to enter various networks or business associations in order to secure bank financing (Oluwarotimi & Sarmistha, 2013). Additionally, the internationalization process of state owned firms or IT start-ups can be fostered by network relationships and support from the government, specialized knowledge and also by chance (Ferencikova & Schuh, 2012). Aside from that and thus, analyzing the network perspective from a different view, the development of manufacturing facilities and MNCs becoming active in the CEE region enabled smaller local firms to access important industry-related networks of big international corporations.

Multiple studies on firm-level internationalization with a focus on the CEE region confirm the significance of the *business networks* and *relationships* described in the network view:

1. One of the first studies supporting the view that entering business network of MNCs is important for the survival of the local CEE companies, is the study of **S. Ferencikova** (2001). She argues that local joint ventures created with the foreign MNCs helped them to survive the transformation crisis through offering them entry into their distribution networks. At the same time, the creation of local joint ventures with the foreign international corporations proved to be vital for some of the local CEE parent companies as well, as they survived the crisis by becoming the supplier of their own joint venture, thus the supplier of the Western parent company (Ferencikova, 2001).

2. The study of **Mroczkowski, Carmel & Saleh** (2003) is another important study showing the relevance of business networks and partnerships. It focuses on the IT exporting firms from Bulgaria, Czech Republic, Hungary, Poland and Romania, which compete for outsourcing work in Western Europe and the USA. The selected firms were at their infant stage, smaller in size and experiencing a lack of financing. These CEE firms were, in comparison to their main competitors, not supported by local governments, which resulted in the following conclusions: firstly, the authors believe that forming strategic partnerships with Western firms is the fastest way to obtain the necessary experience, management expertise and important contacts to large investors. Secondly, partnerships with research institutions and universities represent a great way to obtain young talent, knowledge and information. Lastly, the authors believe that the IT firms should foster the relationships among each other to become stronger and effectively lobby the government if needed (Mroczkowski, Carmel, & Saleh, 2003).

3. As described in the previous section, the study of **Vissak, Ibeh & Paliwoda** (2007), which examines the internationalization processes of four Baltic firms, offers some insights related not only to the Uppsala model, but also the network view. In addition to the previously mentioned findings, the authors conclude that a firm's relationships and business networks are one of the key *internal trigger*s for firm-level internationalization. The fundamental focus lies within the collaboration among foreign partners, research institutions and universities. Membership of the European Union was identified as one of the key influential *external triggers* of a firm's internationalization as well (Vissak, Ibeh, & Paliwoda, 2007). Being part of such a network enabled Baltic firms to focus primarily on Western economies rather than the former Soviet countries.

4. The study of **Musteen, Francis & Datta** (2010) examines 155 manufacturing SMEs founded after 1989 and spread out over different industries in the Czech Republic. The main objective of the study is to observe the business networks of the firms' CEOs and their influence on the internationalization speed and performance of the firms (Musteen, Francis, & Datta, 2010). The findings show that there is a positive correlation between the common language CEOs share with their international contacts and the speed of internationalization. However, the authors explain, that the dependence on personal ties and business networks is more typical for SMEs than for MNCs. Firms in the Czech Republic, especially after 1989, were experiencing a lack of resources, know-how and knowledge; therefore, international networks represented a great option to solve such challenges and problems. Yet, the authors believe that firms should not rely on personal networks too extensively, as it can hinder the performance of their first venture abroad. Additionally, the study observes that geographically diverse networks foster better performance of firms (Musteen, Francis, & Datta, 2010).

5. The study of **Ferencikova (2014)** examines internationalization process of 10 Slovak companies and concludes that the networks were of the significant weight in their entry and activity of the foreign markets. In some cases this was the first and one of the most important precondition of their internationalization success.

4 Conclusions

Based on the empirical evidence on firm-level internationalization of CEE countries, perspectives of the Uppsala model seem to be relevant for state-owned firms, privatized firms and start-ups. Nonetheless, this major theory proves low relevance for multinational firms active in CEE, as they export to regional or global network depending on firm's strategy or the character of the products and services (Ferencikova & Schuh, 2012).

Despite the importance of business networks and relationships for firm-level internationalization, the network view fails to explain why some firms, especially start-ups, internationalize very rapidly even without the necessary network connections at their initial stages. The partial explanation may be found in the fact that the rapid technology advancement has changed the boundaries of the networks, especially in certain industries.

The analysis of both theories helps us to understand the firm-level internationalization processes, and will serve as the platform of the future research of the internationalization of the Slovak companies.

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Contact data:

Prof. Ing.Sonia Ferencikova, sr., PhD., School of Management, Bratislava, Panonska 17, 851 04 Bratislava
sferencikova@vsm.sk

Sonia Ferencikova, jr., MSc., WU Vienna University of Economics and Business
feren1cikova@yahoo.com