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Chapter 6

Conclusions and recommendations for future research

6.1 Introduction

The studies in this book draw attention to two key assumptions of internationalization process models: First, the notion that country differences are the main antecedent to the perception of psychic distance; or, phrased differently, that the degree of uncertainty experienced towards foreign market environments is dependent on the extent to which foreign contexts differ from a firm's home context. And second, the notion that market and resource commitments are based on decision makers' actual knowledge and understanding of local markets. It is these assumptions which lead internationalization theorists to conceptualize the internationalization process as the gradual expansion into increasingly more different countries, paralleled by a gradual deepening of a firm's involvement in those markets in which the firm is already active.

The studies in this book paint a somewhat different picture of the processes underlying internationalization; one in which both knowledge and the subjective beliefs affecting the perception of foreign market environments feature more prominently. Following a conceptual critique of the internationalization process model in Chapter 2, and the development of an index of institutional country differences in Chapter 3, Chapter 4 focused on the factors affecting location decisions. The effect on the location of foreign investment of various country differences associated with reduced psychic distance was contrasted with that of historical ties, a variable associated with familiarity perceptions. Chapter 5 presented the case study of a major German publishing house. The case study explored the effect of familiarity perceptions on individual entry decisions, and focused on the counter-intuitive selection and persistence of high-commitment entry modes in markets of which the German publishing house had very little prior knowledge. This final chapter provides a short summary of the findings and ties together the conclusions that can be drawn

from the separate studies. The closing sections suggest several potential avenues for future research.

6.2 Summary of the findings

Foreign market selection

In Chapter 4 it was argued that in emphasizing the effect of country differences, internationalization process theory overlooks an important dimension of psychic distance. In particular, what determines the perception of psychic distance—and subsequently foreign market selection—is not merely the degree of similarity between the home and the foreign country, but also the extent to which a foreign market environment is perceived as familiar. The familiarity argument builds on the idea that the *perceived* understanding of foreign markets and foreign host contexts depends not only on actual knowledge and information, but also on the unsubstantiated beliefs, assumptions, and generalizations that are held to be true. Implicit beliefs and assumptions may therefore drastically reduce the uncertainty associated with foreign resource commitments, even when the decision maker lacks actual knowledge, and actual differences exist between countries.

The validity of this argument was explored by contrasting the effect of historical ties—a variable associated with familiarity perceptions—with that of country differences on the location of foreign direct investment from the UK, France, Germany, and the Netherlands, over a twenty-year period. The effect of historical ties, common language, and industrial development on investment location proved highly significant, but no support emerged for the idea that firms favour investments in culturally, institutionally, politically, religiously, or educationally similar countries. The establishment of an effect of historical ties—independent of the degree of similarity between countries—provides support for the familiarity hypothesis and challenges the assumption that the degree of uncertainty experienced towards foreign markets is mainly dependent on country differences.

This study is not the first to scrutinize the effect of country differences on location choice. But most studies have traditionally interpreted weak empirical support as evidence against the notion of psychic distance, rather than against its alleged antecedents. Instead, the empirical results in this study illustrate that an important dimension of psychic distance, the perception of familiarity, may have been overlooked. In addition, the results suggest that not all country differences may have equal weight as a psychic distance stimulus. This adds to studies which have emphasized the importance of perception in measuring psychic distance (Dow, 2000; although with some emphasis on perceived country differences), or the importance of considering actual information sources (Brewer, 2007).

Foreign market commitment

The case study in Chapter 5 suggests that familiarity perceptions may similarly affect decisions on the development of a firm's operations *within* foreign markets. Internationalization process theory views a lack of knowledge as one of the key impediments to the internationalization process of firms. Yet the case study illustrated that internationalization process theory may have neglected that in the absence of local knowledge, internationalization decisions may instead be based on unsubstantiated beliefs and assumptions on the nature of foreign market environments, which increase familiarity perceptions. Therefore, similar to how superstitious beliefs may "fill the void of the unknown and [...] reduce anxiety" (Tsang, 2004: 96), strong beliefs and assumptions on foreign market environments may reduce some of the risks and uncertainty associated with entering new markets. This, I argued, may explain the selection of high-commitment entry-modes in foreign markets of which the firm has little actual knowledge.

The case study in Chapter 5 thus adds to a small number of studies which challenge the assumption that commitment decisions are primarily based on the actual knowledge firms have of foreign markets. Perhaps most significant in this regard are the contributions by Jonathan Calof (Calof, 1993; and Calof and Beamish, 1995), who observed that 39% of the mode-change decisions in his sample were primarily based on gut feel and subjective beliefs about the foreign market environment, whereas another 28% of these decisions were based on a combination of both gut feel and rational decision making (Calof, 1993). Both the work of Calof and Chapter 5 illustrate that in emphasizing the importance of experiential knowledge, internationalization process theory may have largely overlooked the effects of subjective beliefs on internationalization decisions.

MNE responses to unlearning

In addition, this study draws attention to the potential implications of (cultural) learning processes; or more specifically, to what happens when initial beliefs and key assumptions are disconfirmed. The alternative responses to unlearning noted in the case study in Chapter 5 suggest that the MNE's response to unlearning may well be contingent on whether the disconfirmed assumptions pertain to the strategic requirements of the industry or to the nature of the foreign host context: While the disconfirmation of key assumptions on the strategic requirements of the industry is likely to result in an adjustment of the MNE's organizational model, a change in market commitment is a more probable response when key assumptions about the nature of the foreign host context prove incorrect.

MNE responses to exposed knowledge deficiencies have so far received little attention in the IB literature, especially in contrast to, for example, MNE responses to

changing environmental pressures (e.g. Buckley and Ghauri, 2004; Bartlett and Ghoshal, 1989). Similarly, while the literature on internationalization knowledge has examined the effect of internationalization on the accumulation of different types of experiential knowledge (e.g. Eriksson et al., 1997; 2000), there have been few attempts to link the effect of different types of knowledge back to variation in internationalization decisions. By drawing attention to the alternative responses to different types of unlearning processes, the case study opens up interesting new avenues for future studies.

But perhaps most interestingly, Chapter 5 draws attention to the interrelated nature of internationalization decisions. In International Business studies, there is a tendency to consider internationalization decisions separately; such as entry-mode selection or, as in Chapter 4, the location of foreign investment. In contrast, Chapter 5 illustrates that the persistence of relatively committed modes of operation may be better understood when changes in the MNE's organizational model are considered. It may well be that other internationalization decisions—rarely taken in isolation—prove to be similarly interdependent.

6.3 Foreign market familiarity: implications for internationalization process models

What emerges from the findings is that in addition to a lack of resources, the most important impediment to internationalization may be the uncertainty internationalizing firms experience due to the perceived lack of familiarity with foreign host contexts and organizing foreign operations. This suggests that apart from the perceived attractiveness of foreign markets, the internationalization process of firms is driven by the extent to which foreign markets are perceived as familiar, which reduces the risk and uncertainty associated with foreign market commitments. This notion advances the work of internationalization process theorists in that internationalization decisions may not only be based on the limited (experiential) knowledge decision-makers have (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977) but also on the beliefs which decision-makers hold to be true on the nature of foreign markets, and on the appropriate ways to organize a firm's foreign operations.

This notion finds support in empirical studies (Calof, 1993; Calof and Beamish, 1995) as well as in the behavioural literature on which internationalization process theory builds. For example, Aharoni (1966) observes how ethnocentric beliefs may affect the perceived attractiveness of investing internationally, and that “[t]he fact that some of these beliefs are incorrect, exaggerated, or based on half truth is not important when one deals with the decision-making process. The important thing is that people believe them to be true” (Aharoni, 1966: 96). Similarly, the concept of bounded or subjective rationality implies that decision-makers act both on the limited knowledge that is available and on the boundary of this information-space, which

contains both the beliefs that are held to be true and the assumptions that have to be made (March and Simon, 1958; Simon, 1991). One of the objectives of this book has been to argue and illustrate that incorporating these notions into internationalization models changes the internationalization patterns which can be expected.

First, instead of selecting foreign country markets which are most similar to the home country, international neophytes may start in country markets which are perceived as relatively familiar. Through international experience, firms subsequently become more knowledgeable on how to manage their international operations and become adept at understanding new country markets (Eriksson et al., 1997; 2000). This can be expected to reduce some of the risk and uncertainty experienced towards less familiar country markets, stimulating subsequent market entries. Second, attributing a more central role to the perception of host country familiarity implies that even from a behavioural perspective, the notion of foreign market incrementalism does not necessarily hold. Strong beliefs, assumptions, generalizations and prejudices on the nature of a foreign host context may permit considerable market commitments despite a lack of actual knowledge of the foreign market environment and the foreign host context.

What does not change, however, is the importance of experiential learning in understanding internationalization processes. While a variety of factors may give rise to perceptions of foreign market familiarity, beliefs and assumptions are no substitute to actual knowledge and a real understanding of foreign markets and foreign contexts, which requires local experience (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977). And while familiarity perceptions may facilitate foreign entries into countries that differ markedly from the home country, the performance implications may be dire if the perception of familiarity stems from false beliefs rather than actual knowledge (see O'Grady and Lane, 1996).

If anything, however, the studies in this book perhaps best illustrate that the behavioural dynamics that shape internationalization patterns are far from simple and straightforward; a fact which is too often overlooked in overly specialized IB studies. Whether and what country differences serve as antecedents to the perception of psychic distance may differ depending on entry mode (Chapter 4), and internationalization involves both the gradual accumulation of experiential knowledge, and the disconfirmation, rejection and unlearning of false beliefs which earlier may have guided internationalization decisions (Chapter 5). Similarly, the response of MNEs when false beliefs are disconfirmed may differ depending on whether the false beliefs pertain to foreign market characteristics or to strategic industry requirements. Therefore, contrary to some suggestions, I believe that internationalization process theory should not be discarded as an outdated model of international firm behaviour, but that it provides fertile ground for future research.

6.4 Research limitations

There are some obvious limitations to the conclusions that can be drawn. A first limitation stems from the use of country-level data in the study on the location of foreign investment (Chapter 4). What sets apart internationalization process theory from other theories on internationalization in International Business is the emphasis on the dynamics or processes underlying internationalization patterns. Yet the use of country-level rather than firm-level data implies that the effect of the familiarity variable—historical ties—on internationalization sequence cannot be commented on. To some extent, the case study corrects for this lack of attention to process, but the specific focus of the case study is on the development of local market-commitments rather than on foreign market selection.

A related limitation is that data on foreign direct investments does not capture the various forms of non-equity-based foreign market involvement, such as licensing or exporting. Therefore, as discussed in Chapter 4, the results may merely hold for a particular type of internationalization decision. A comparison of the results of Chapter 4 with the results of Dow and Karunaratna (2006), who use trade intensity as their dependent variable, illustrates that the relative contribution of various psychic distance stimuli may differ, depending on the entry mode decision (see Chapter 4).

However, even though using foreign direct investments to study location decisions is not necessarily perfect, there are also clear advantages of analyzing foreign direct investments over individual location decisions. As direct investments are the aggregate of location decisions multiplied by invested volume—or weighted location decisions as it were—it is arguably a more appropriate measure for the propensity of firms to overcome distance than the indiscriminate analysis of unweighted location decisions. In other words, it is actually quite appropriate to test a hypothesis derived from decision theory by addressing bundles of identical decisions weighted by volume.

A final limitation has to do with the generalizability of the case findings in Chapter 5. The embedded case study of the internationalization process of a German publishing house is illustrative, as it concerns a typical case in which a firm's involvement in new foreign markets does not progress gradually. In addition, the case study illustratively demonstrated two alternative adaptive processes to unlearning. Yet the case study methodology also gives rise to the question to what extent the case findings can be generalized. On the basis of an embedded case study, no *generalized* statements can be made on the effect of familiarity perceptions on entry mode selection, or on the extent to which the response of MNEs to the disconfirmation of false beliefs is contingent on knowledge-type. Rather, the conclusions that can be drawn based on the case findings can only be generalized to tentative propositions, each of which requires future study.

6.5 Directions for future research

While the role of experiential knowledge in the unfolding internationalization process of firms has received due attention (e.g. Erramilli, 1991; Eriksson et al., 1997; 2000), subjective beliefs about foreign contexts have so far been rarely considered. The familiarity argument developed in this book paves the way for a closer examination of behavioural explanations in our understanding of both entry mode decisions and subsequent shifts in the mode of operation. In terms of future research directions, a first line of research should therefore focus on examining the key antecedents to perceptions of host country familiarity. This may lead to better—more direct—indicators of familiarity perceptions than the historical ties proxy used in Chapter 4. Individual ties, social networks, and media coverage for example, are just some of the factors which may further affect familiarity perceptions.

Second, the studies in this book motivate additional studies on the effect of familiarity perceptions on internationalization decisions—in particular in relation to the effect of country differences. Comparing the findings of Chapter 4 with the results of Dow and Karunaratna (2006) suggests that while language influences investment decisions, common language is not similarly conducive to trade. In similar vein, the results of Chapter 4 suggest that familiarity perceptions affect foreign investment decisions. However, the question whether familiarity perceptions also affect non-equity-based entry mode decisions remains unanswered. As discussed in Chapter 4, such issues fuel further interest in the question what psychic distance stimuli matter with what entry mode decision.

Another question that is largely left unanswered is the extent to which familiarity perceptions affect the internationalization sequence of firms, or the order in which foreign markets are entered. The study on location decisions in Chapter 4 makes use of country-level data. As such, the level of analysis makes it impossible to comment on the effect of historical ties on the actual internationalization sequence of individual firms, or on the commitment of resources to foreign markets over time. As internationalization process theory is particularly concerned with the processes by which firms internationalize, I encourage future studies employing firm-level data to examine the effect of familiarity perceptions on internationalization sequence.

Future research should also focus on the performance implications of incorrect familiarity perceptions. As suggested throughout this book, familiarity perceptions may stem just as well from subjective beliefs and assumptions as from an actual understanding of foreign host contexts. This raises the question to what extent poor international performance can be attributed to incorrect representations of foreign host contexts. Several earlier studies have addressed the relation between psychic distance and international firm performance, such as O'Grady and Lane (1996), Evans and Mavondo (2002), and Evans, Mavondo, and Bridson (2008). This line of research

may benefit from the conceptual differentiation between potential drivers of psychic distance perceptions proposed here.

Perhaps the timeliest of these research questions are related to the antecedents of psychic distance. Following the persistent use of cultural distance as the most commonly applied psychic distance surrogate, the last decade has seen considerable debate over how psychic distance can be measured. In Chapter 4 I argued that both a proper conceptualization and operationalization are first requirements to assessing the extent to which psychic distance affects internationalization processes. As it stands, it has been emphasized that psychic distance refers to perceptions (Dow, 2000), and that both actual information sources (Brewer, 2007) and subjective beliefs (Chapter 4) are more likely antecedents to such perceptions than mere country differences. In the actual measurement of psychic distance perceptions I see a clear role for psychometricians, while additional research should establish the extent to which individual psychic distance perceptions can be generalized to the organizational or country level.

Appendices

