

CALL FOR PAPERS

Special Issue of the Journal of International Business Studies

APPLYING AND ADVANCING INTERNALIZATION THEORY:

EXPLAINING THE EXISTENCE OF THE MULTINATIONAL ENTERPRISE IN THE 21ST CENTURY

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Deadline for submission: June 1, 2017

Tentative publication date: Summer 2018

Introduction

Forty years ago, Buckley and Casson (1976) published *The Future of the Multinational Enterprise*. Following the intellectual legacy of Coase's (1937) transaction cost economics, Buckley and Casson (1976: 33) argued that the multinational enterprise (MNE) internalizes activities across national boundaries "when markets in intermediate products are imperfect [because] there is an incentive to bypass them creating an internal market." Hennart (1977, 1982), in parallel to Buckley and Casson (1976), contributed to the theory of the MNE by considering perspectives of transaction costs such as measurement and enforcement costs arising due to bounded rationality and opportunistic behavior in markets. Bringing an early resource-based perspective to internalization theory (before the notion of resource based view or RBV had even been coined in the field of strategy), Rugman (1981) explained internalization decisions made by the firm on the basis of firm specific advantages (FSAs) and country specific advantages (CSAs), while Rugman and Verbeke (1992, 2003, 2004) expanded on the geographic reach of these FSAs, thereby making the critical distinction between location-bound and non-location bound FSAs. Rugman and Verbeke (2001) also uncovered 10 distinct patterns of competence building across borders in MNEs that resulted from particular interactions between FSAs and CSAs, thereby acknowledging the joint importance of entrepreneurial action, transaction cost economizing and requisite resource combination inside the MNE. In parallel, the Eclectic Paradigm (Dunning, 1977, 1988, 1993; Dunning & Lundan, 2008) stressed the joint impact of ownership, location, and internalization advantages to explain the existence and functioning of the MNE. In combination,

these theoretical advances have contributed to the establishment of *internalization theory* as a generally accepted theory of the MNE – and as an analytical framework that has explicitly or implicitly underlined much of the progress being made in International Business (IB) research over the last four decades. Internalization theory allows predicting a great number of organizational regularities in IB. These range from entry mode choices – and more generally the governance of international transactions, including the rise of international new ventures (INVs) – to internal organizational design in terms of structural and strategic governance, as well as the structuring of the interface with external economic actors. Yet, a number of issues still remain unresolved, and new questions have emerged—in particular, about the continued applicability of internalization theory in a rapidly changing world, and about the foundations of the theory in light of new developments in other fields and disciplines. This special issue on Applying and Advancing Internalization Theory invites original research that addresses these questions.

As noted by Rugman and Verbeke (2003: 125), *The Future of the Multinational Enterprise* was “a superb starting point for the study of the MNE, even if the complexity of this governance structure has grown far beyond what any international business scholar ... could have predicted 25 years ago”. This is even more evident today as the nature of the global economy has changed and continues to change. Novel types of cross-border transactions and forms of MNEs have arisen, raising questions about the universal applicability of the theory. It is now time to revisit the theory of the MNE and to challenge its underlying assumptions. More advanced theoretical and empirical approaches promise to identify and explain better the little explored causal mechanisms leading to the existence or absence of MNEs. Analysis of these mechanisms will highlight not only the “why” but also the “how” of internalization theory. To advance this research agenda, we invite manuscripts from a variety of disciplines, including management and organizational studies, strategy, economics, economic geography, marketing, etc. Ideally, submitted manuscripts should improve upon the current state of internalization theory and its implications for managerial practice, by criticizing or extending the conventional thinking embedded within it. We welcome diverse approaches to this topic, including (but not limited to) conceptual models, formal models, simulations, experimental designs, and empirical studies (both qualitative and quantitative ones). Specifically, we invite submissions falling within one or both of the two themes described below.

Theme 1. Applying Internalization Theory to New Realities: Firms and Markets in the Contemporary Global Economy

Building upon general economic principles, applicable across a wide range of empirical phenomena, many scholars have credibly used internalization theory as an analytical tool in different institutional contexts. The theory has allowed explaining the presence of a variety of governance forms for managing international transactions (Casson, 1995, 2015; Narula & Verbeke, 2015). At the same time, few will dispute the fact that the world looks dramatically different today than it did when internalization theory first emerged. IB scholars therefore need to pay special attention to the new realities of the international economy and their influence on the evolution of MNEs.

A key tenet of internalization is that MNEs arise to exploit imperfections in markets, imperfections that are influenced by the myriad changes often referred to under the conceptual umbrella of “globalization”. These include political developments pertaining to economic integration, trade agreements, currency regimes, and other supra-national institutions that transform both the cost of managing firms across borders and of transacting in international markets (Rugman & Verbeke, 2005). They also include technological advances such as internet-based collaboration tools, virtual communities of practice, and online market exchanges, which have equally strong transaction cost implications (Bakos, 1998; Ardichvili, 2008). In combination, these developments have paved ways for new types of firms and novel business models. Firms are also geographically more dispersed than ever, engage in co-opetition, have diffused innovation, and deploy global teams as well as virtual organizational structures (Axinn & Matthyssens, 2002).

Accordingly, two issues that loom large in this new world economic system are the growth of the service sector and the advent of the digital economy. The interactions that e-commerce firms have with their customers tend to possess different attributes and thus alter the cost-benefit calculus of various governance modes, as compared to the manufacturing sector (Singh & Kundu, 2002). Increasingly, new ventures aim to internationalize, right from inception, by leveraging advances in information technology. Widening geographic spread, alternative governance structures to access and control unique resources, and internalization of the core of value chain have strong theoretical implications (Oviatt & McDougall 1994; Verbeke, Zargarzadeh, & Osiyevskyy, 2014). In this process, the role of the subsidiary has become more vital, reflected in the growing importance of subsidiary specific advantage (Rugman and Verbeke, 2001; Mudambi and Navarra, 2004; Meyer, Mudambi, & Narula, 2011) and reverse innovation in MNEs (Mudambi, Piscitello, & Rabbiosi, 2014). As reflected in the concept of “meta-MNEs” (Lessard, Teece, & Leih, 2016), the existence of which can be explained by internalization theory (Verbeke & Kenworthy, 2008), the ability to earn economic rents from the creation of knowledge assets in subsidiaries around the world depends upon advantages of common governance. Yet there are also substantial costs of managing increasingly complex organizations and combining external and internal embeddedness in dispersed subsidiaries (Narula, 2014).

The same technological developments, in parallel with managerial and organizational developments, have also enabled MNEs to operate with increasingly porous boundaries (Regan & Heenan, 2010). The twenty-first century has witnessed the growth of networks and coalitions between firms (Dunning & Boyd, 2003), while the importance of relational assets and social capital has increased over time to as firms aim to access new knowledge (Dunning, 2003). The phenomenon of “quasi-internalization” has thus become increasingly relevant in today’s competitive landscape as organizations seek to utilize a middle-of-the-road approach to organize their activities – via both hierarchy and markets. Since the seminal paper of Hennart (1993) on the “swollen middle”, there has been a growing interest on MNEs’ minimization of organizational cost by looking at shirking, cheating, monitoring and other costs, recognizing that the choice is not one between internalization and externalization, but of a contextually contingent combination including outsourcing and alliances (Dunning, 2015).

These developments, which are often closely interlinked, present unique opportunities for theory development as they reveal the diverse strategies, challenges, and imperatives of the modern MNE. For example, does internalization theory apply, or perhaps apply differently, to alternative governance forms and structures, such as service firms, e-commerce firms, conglomerate businesses, state-owned enterprises, born global firms, family-owned MNEs, and Bottom-of-the-Pyramid MNEs? Does the rise of new business models based on new technologies or management principles influence the choice between internalization and externalization? How do MNEs mitigate opportunism, moral hazard, free riding, and other associated costs when generating and leveraging relational assets for productive gains? Is it even meaningful to continue to talk about the choice between firms and markets when the nature of contemporary economic exchange is often approaching one of quasi-internalization? Application of the theory to new and evolving contexts may bring new insights into subtle mechanisms, and ultimately inform the structure of the theory itself. With this theme, we welcome contributions that reflect the applicability (or partial applicability or even inapplicability) of internalization theory to the new realities of the contemporary global economy.

Theme 2. Advancing Internalization Theory by Rethinking its Foundations: Rationality, Learning, and Evolutionary Dynamics

Just as the context of internalization theory has changed, so has the way in which academics within and outside IB think and theorize about this context. With these changes, there is a so far largely untapped opportunity to integrate theoretical advances and empirical approaches from other disciplines into research on the MNE. Such integration has only recently and partially begun to take place, with various perspectives making excursions into the realm of IB. These include different disciplines, such as political economy (Henderson, Dicken, Hess, Coe, & Yeung 2002) and economic geography (Baldwin & Venables, 2013), as well as different approaches to theorizing, such as those related to microfoundations (Foss & Pedersen, 2004), general equilibrium modeling (Buckley & Hashai, 2009), co-evolutionary economics (Pitelis & Teece, 2010), equifinality (Raymond & St. Pierre, 2013), and agent-based simulation (Asmussen, Larsen, and Pedersen, 2016). However, uncharted territory still abounds and it is an open question how these perspectives can be subsumed into internalization theory, and in what ways they extend, refine, and challenge this theory. With this theme, we therefore aim to “open up the black box” of internalization theory and revisit its foundations.

One issue that sits squarely in this black box is the issue of behavioral assumptions. Internalization theory mostly predicts that effective governance forms will prevail, thereby implicitly or explicitly deriving its predictions from a profit-maximizing (or cost minimizing) paradigm (reflecting its roots in economic theory). Empirical evidence, in turn, mostly supports the predictions emerging from this paradigm, including predictions of foreign entry modes (e.g., Anderson & Gatignon, 1986; Agarwal & Ramaswami, 1992), location choices (e.g., Friedman, Gerlowski, & Silberman 1992; Mariotti & Piscitello, 1995), and performance (e.g., Kirca et al., 2011; Kirca, Fernandez, & Kundu 2016). However, we know surprisingly little about how these outcomes actually emerge. At the same time, economists themselves have continued to refine and challenge the notion of rationality. More precise concepts developed within the Coasean paradigm, such as adverse selection, moral hazard, holdup, have further enriched the analysis using the basic internalization approach (Chi, 1994), and imperfections such as bounded rationality and bounded reliability have

been more completely developed (Verbeke & Greidanus, 2009; Kano & Verbeke, 2015). Even more radical departures from orthodoxy have come from new perspectives such as behavioral game theory (Camerer, 1997) and fairness equilibrium (Rabin, 1993). In this process, the barriers between economics and the other social science disciplines have become more porous and alternatives to economic rationality concepts, for example altruism (McWilliams, Siegel, & Wright, 2006) and collective identification (Cooper & Thatcher, 2010), have been applied to organizations and business settings.

These observations raise a number of related questions pertaining to internalization theory. For example, who makes the decisions about internalization and externalization? What guides these decision processes in terms of expectations, learning, and feedback loops, and how are those influenced by bounded rationality and by the challenges of measuring transaction costs? Which selection mechanisms (for example, competition in the markets for managers, capital, labor, or products) ensure efficient outcomes and under which conditions? What are the dynamic implications in terms of the evolution of firms and markets in a global context, and the performance of firms in the short and long term? To answer these questions, we need a better understanding of the causal mechanisms underlying the theory of the MNE, the scope of predictions supported by its assumptions, and the consequences of relaxing these assumptions. Obviously, any modifications to the assumptions and analytical logic of internalization need to be explicitly spelled out to ensure commensurability and logical consistency.

In rethinking the foundations of internalization theory along the above lines, new theoretical developments in adjacent research fields may provide leverage. These include, for example, the considerable research efforts on the governance of global value chains that have been undertaken since the 1990s in the fields of sociology, economic geography, development studies, and political economy. Scholars in these fields have examined issues such as sourcing (Gereffi 1999; Kaplinsky 1998; Dolan & Humphrey 2000) and contract manufacturing (Schmitz & Knorringa, 2010). Since the early 1990s, various frameworks have been put forward in attempting to explain how global industries are organized and governed (Coe, Dicken, & Hess, 2008). In their discussion of the organization of economic activities, these studies implicitly relate to the issue of global markets versus hierarchies that internalization theory also addresses, but so far very little cross-fertilization has occurred between these research streams.

Finally, similar to the governance aspects, the spatial aspects of internalization theory arguably remain equally underdeveloped, leaving ample opportunities to further integrate geographic aspects into studies of the MNE (Dunning, 1998). The ongoing analyses of semi-globalization (Ghemawat, 2003) and discontinuities in geographic space (Beugelsdijk and Mudambi, 2013) suggest the need to revisit accepted IB theories with the added insight of supra-national geographic levels, such as regions (Rugman and Verbeke, 2004; Arregle, Miller, Hitt, & Beamish, 2013; Verbeke & Asmussen, 2016), and of sub-national geographic levels, such as cities (Goerzen, Asmussen, & Nielsen, 2013). With this theme, we aim to integrate insights from the above-mentioned disciplines (and potentially other ones) outside of IB, into our understanding of the existence and boundaries of the MNE.

Conclusion

Of the two themes, the first has an emphasis on phenomena and the second on theory, but both themes have in common their focus on the MNE. Importantly, the two themes are not independent—for example, it is possible that the application of internalization theory to new contexts requires a re-specification of its assumptions, or that the change of assumptions leads to new predictions that require specific context for empirical testing. Overall, the aim of the special issue is to encourage academic research that develops more fine-grained analysis of how the MNE decides on its boundaries and on the organizational forms it takes. On particularly important, “intelligently controversial” questions, the editors may decide to foster debate using a point-counterpoint format. We hope that the collection of papers in our special issue will contribute to the evolving research on MNEs so as to create a more formative unified theory and a common epistemology for comprehending the evolution of MNEs within the ongoing progression of international business activities.

Submission Process

All manuscripts will be reviewed as a cohort for this special issue. Manuscripts must be submitted in the window between May 15, 2017, and June 1, 2017, at <http://mc.manuscriptcentral.com/jibs>. Please indicate in the cover letter which theme(s) of the two described above the submitted manuscript addresses. All submissions will go through the JIBS regular double-blind review process and follow the standard norms and processes.

For more information about this call for papers, please contact the Special Issue Editors or the JIBS Managing Editor (managing-editor@jibs.net).

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