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Managing the Internalization Process

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Abstract

The internalization theory informs us well about why and when multinational enterprises (MNEs) internalize foreign operations - but less about *how* the internalization should be prepared and exercised when foreign market operations initially are carried out by local, outside agents. The internalization theory therefore tends to have greater appeal to international business researchers than to managers of MNEs. However, insights from recent international business literature as well as from marketing and management literature may transcend internalization theory beyond its neoclassical and deterministic boundaries into a more prescriptive theory. With these literature insights incorporated the paper aims to elicit best practice management of situations where the market transaction costs of using outside agents are negligible at market entry, but are growing over a period of time. A key question pertaining to this situation is: what management instruments may ensure persistent concurrence between changing internalization advantages and the operation methods used in the foreign market? Management instruments and strategies that potentially enable a desirable 'staged internalization' include appropriation - pari passu with increasing internalization advantages - of the local, outside agent's equity, assets, user rights, customer relations, and value added activities.

Key Words: Internalization, best practice, management, MNEs

Managing the Internalization Process

1. Introduction

Presumably, any researcher within business economics will approve of the practical use of theory; if only because this brings the economy closer to the ideal Pareto optimum. Conceiving economic theories as evolving according to a sequential pattern with stages of increasing sophistication, the much-coveted (but not always attainable) ultimate stage is that of a theory which can improve business practice, in other words a prescriptive or normative theory.

In this paper we aim to contribute to further development of one of the most influential and successful descriptive theories within the IB area - the internalization theory – in the direction of becoming a prescriptive theory as well. We do so by eliciting best management practices of situations where the market transaction costs of using outside agents (local operators) are negligible at market entry, but are growing over a period of time. A key question pertaining to this situation is: what management instruments may ensure persistent fit between changing internalization advantages and the operation methods used in the foreign market?

The internalization theory (McManus, 1972; Buckley and Casson, 1976; Rugman, 1981; Hennart, 1982) has successfully explained under which circumstances a firm replaces imperfect (or non-existent) external markets by internal ones (Buckley, 1993). Together with market power explanations (Hymer, 1960/1976; Yamin, 1994) and knowledge-based explanations (Kogut and Zander, 1993; Grant 1996) internalization theory offers a paradigm able to explain - with a high degree of accuracy - why multinational enterprises (MNEs) have chosen to exercise daily managerial control over foreign operations. Hence, on a general level internalization theory can explain the existence of MNEs. By including time-varying factors that pull in the direction of internalization (see next section) the theory can also predict patterns and directions of growth of MNEs.

Our discussion of the management aspects of internalization theory takes off in an article from 1993 written by Peter Buckley - one of the theory's originators. In this article Buckley concludes that the internalization theory at that time – the beginning of the 1990s - by no means was ignoring the role of management inasmuch as "strategic behaviour can be identified within the internalization framework by firms securing exclusive access to key inputs and tieing in customers." (p. 205). However, Buckley also found considerable room for developing the theory in a more management-oriented direction. In particular, we notice his plea for theory development in relation to the following two, closely interrelated issues:

Firstly, the theory's rather static view of the internalization – considered a state rather than a process. Hence, "to incorporate a theory of management, it is essential to move away from a comparison of states to a comparison of processes… Progress can be made by comparisons of the changing balance of the boundary between 'firm' and 'market' and intermediate states over given time periods." (Buckley, 1993: 201). Secondly, the oversimplified choice between markets and hierarchies. Hence, "the narrow view that managers simply make 'buy or build' decisions (…) needs to be extended." (Buckley, 1993: 205).

The two issues point in the same direction, namely that internalization may be a long-termed manageable process rather than a time-compressed, binary choice.[1] The contextual focus of this paper is those situations where non-hierarchical entry modes enjoy a temporal superiority over hierarchical modes (for reasons that will be elaborated on in the next section). As an example, licensing or joint ventures may forego wholly-owned production subsidiaries, or independent distributors may precede sales subsidiaries.

[1] Of course, in those situations where no markets – not even contractual – exist internalization from the outset is the sole foreign entry mode, and it is meaningless to talk about internalization *processes* (other than post-internalization processes – such as post-acquisition integration processes). Most often, however, non-hierarchical entries (i.e. arm's length, contractual market, and shared ownership operations in foreign markets) are feasible alternatives to establishing wholly-owned subsidiaries.

On this background we will use the term *staged internalization* for those cases where the transition from non-hierarchical to hierarchical foreign operation modes unfolds as a managed and stepwise process. We concede that the potential pay-off to MNEs of undertaking staged internalization is considerable. In an ideal management scenario at any point in time the degree to which a firm has internalized its foreign activities should be in perfect balance with the underlying drivers of internalization. An example: An MNE has many different value added activities going on in a certain foreign country. Some of the activities in this country are characterised by a high degree of asset specificity whereas other activities have low specificity. Because of considerable scale & scope economies and local market knowledge enjoyed by a local, outside agent (e.g. a licensee of the MNE) the entrant MNE only internalizes local activities of high asset specificity, such as R&D (Buckley and Hashai, 2005). Furthermore, the MNE internalizes more and more value added activities in the foreign country as the degree of asset specificity of these activities grows, that is, in small, consecutive steps.

Figure 1 illustrates three scenarios that are different in terms of the fit between underlying internalization drivers (indicated by the broken line), such as increasing asset specificity, and *effectuated* internalization of operations in a given foreign market (indicated by the full line). It is assumed that the underlying pressure for internalization (or, internalization advantage) increases steadily and linearly with elapsed time of operations in the foreign market. Thus, the X-axis indicates elapsed time of operations in the market and the Y-axis the degree to which the foreign market operations is internalized (measured as a continuum from 0-100 %).

--- Insert Figure 1 about here ---

Figure 1-a depicts a scenario of immediate internalization that, for example, may be justified by excessively high anticipated/potential switching costs (Benito et al., 1999). Although economically justified by threatening switching costs, the internalization is ‘premature’ inasmuch as the hierarchical operation mode – the wholly-owned subsidiary (WOS) - in contrast to e.g. a local, independent licensee - operates below minimum efficient scale during the first years after market entry. Hence, the governance structure is sub-optimal in terms of production costs (although not as regards transaction/switching costs). The suboptimization in

terms of production costs (i.e. sacrificed scale economies) is indicated by the grey area. Figure 1-b illustrates a scenario with one shift of governance structure – from a contractual mode (e.g. licensing) to the hierarchical mode (WOS). The shift halves the suboptimization (grey) area. The suboptimization area is further reduced when the MNC makes two shifts of governance structures/operation modes (Figure 1-c): First from a contractual arrangement to a 50/50 equity joint venture, and later from a joint venture to a sole venture - a hierarchical organisation (WOS). Altogether, the three scenarios show that the suboptimization area diminishes as the number of shifts – internalization steps – increases. Ideally, a perfect concurrence between the particular *need* for internalization at a certain point in time (determined by the underlying internalization drivers) and the *actual* internalization at that point in time would eliminate the suboptimization area completely (or more precisely, asymptotic toward zero). It is also clear that there is a trade-off between - on the one side - production cost savings due to perfect concurrence obtained through frequent internalization steps, and - on the other side - additional transaction costs in the form of renegotiation costs.

It is a basic premise of the paper that the attainment of a perfect fit between underlying internalization drivers and effectuated internalization has a high payoff, but at the same time constitutes a major managerial challenge. On the ensuing pages we will explore this exciting management challenge.

The balance of the paper is organised as follows: In the next section (section 2) we account for different dynamic drivers of internalization that trigger either increasing costs of using an external organization (i.e. increasing market transaction costs) or decreasing costs of using an internal organization (e.g. shrinking penalty costs of underutilized production capacity). In section 3 we delineate the managerial scope for staged internalization and discuss the roles of management in internalization theory as today and the possible extension of these roles. Inspired by extant IB, marketing and management literature section 4 examines different *modus operandi* of ‘staged internalization’, including gradual appropriation of equity, assets, user rights, customer relations and value added activities of the local, outside agent. The section includes a number of real-life practical examples of how MNEs already at foreign market entry put in place internalization options in order to curb renegotiation costs of multiple contract adjustments at later points in time. Section 5 concludes.

2. Dynamic drivers of internalization

Why is it that an MNE should not always internalize its activities in a foreign country overnight? What are the dynamic drivers that *gradually* build up a pressure for internalization as the activities in the foreign country unfold, and therefore suggest that effectuation of internalization should be *gradual* as well? There are probably many dynamic drivers of internalization (likewise drivers of externalization – confer e.g. the franchising literature) and the aim of this section is not to provide a full account for these 'drivers', but only to mention four of the most obvious that are well-described in the business economics literature. The four drivers of internalization fall into two groups: One type of dynamic drivers triggers increasing market transaction costs of using an external organization. The dynamic driver *none sine qua* of this type is the 'fundamental transformation' (Williamson, 1985) – i.e. the change from a large to a small number bargaining situation and eventually a bilateral monopoly - a lock-in situation. The increasing economic interdependency between the two parties – *in casu* an entrant MNE and a local operator – builds up the pressure for internalization. The other type of dynamic driver is leading to decreasing costs of using an internal organization. There are – at least - three drivers of this type: (a) increasing sales volume or market size; (b) diminishing market uncertainty through experiential learning, and (c) release of management resources. Usually, the three drivers cannot, by themselves, justify internalization – they only bring down the cost of using hierarchical modes on par with the costs of arm's length and contractual solutions. In other words, they do not really constitute a 'pressure' for internalization, but lower the threshold of internalization in case market imperfections arise, such as hold-up situations provoked by asset specificity (Williamson, 1983).

Increasing asset specificity (Williamson, 1975/1985): The change from a large to a small numbers bargaining/exchange situation increases the degree of asset specificity between the exchanging economic agents. The increasing asset specificity leads to prohibitively costly haggling about the quasi rent resulting from the mutual adaptation that, in turn, provokes the so-called 'fundamental transformation' from an arm's length market structure to a hierarchical governance structure. Hence, Williamson describes a *process* - the fundamental transformation - of increasing asset specificity eventually leading to internalization, but the governance structure is either market or hierarchy[2]. In other words, the internalization is presented as a one-off switch.

Increasing sales volume or market size (Buckley and Casson, 1981): Growing market size may constitute an internalization driver inasmuch as contractual operation methods (e.g. licensing) in general are more economical at a small or medium local market size than are investment modes (FDIs). In Figure 2 the market size Q** indicates the 'switch point' where the costs of operating a contractual foreign operation mode equals an investment mode.

--- Insert Figure 2 about here ---

In this presentation the entrant firm faces a make-or-buy choice: either contract or FDI (as we disregard the location choice between export and local production). Again, the internalization is presented as a one-off phenomenon.

Diminishing market uncertainty through experiential learning (Johanson and Vahlne, 1977): The entrant firm's acquisition of foreign market knowledge reduces the perceived market risk which, in turn, prompts the entrant firm to internalize, i.e. switch from a sales agent to a sales subsidiary – see Figure 3. In the Uppsala model, the internalization is driven by a learning process. However, it is less clear to what extent the internalization as such - the switch from a sales agent to a sales subsidiary – is a process as well. Johanson and Vahlne (1977) suggest a gradual increasing resource commitment to foreign market, but the archival data of the four Swedish MNEs, from which Johanson and Wiedersheim-Paul (1975) derived the 'establishment chain', indicate a one-off switch - not a process.

--- Insert Figure 3 about here ---

Petersen et al. (2001) discuss this discrepancy between the theoretical and empirical /operational level of the Uppsala model and outline how an incremental learning process in fact may be echoed in an incremental internalization process.

[2] Though, later on Williamson included contractual governance structures as "hybrid forms" (Williamson, 1991) thereby leaving a strict market-hierarchy framework.

Release of management resources (Penrose, 1956/59): Penrose demonstrated how growing managerial scope economies - of e.g. US car manufacturers, see Penrose (1956) - release management resources that, in turn, can be employed in the establishment of foreign production subsidiaries. In general, the growth of an entrant MNE may free financial funds and human resources that enable internalization. Whereas the growth of the (entrant) firm is a process *per se*, it seems to be unresolved in the literature if the internalization that arises from the growth is a one-off event or a process.

In sum, extant business economics literature gives us a general picture of various underlying drivers or forces of internalization, including increasing market size, experiential learning, firm growth, and increasing mutual interdependency. The internalization as such, however, is either assumed to be in place from the outset (as a hierarchical entry mode), or exercised as a one-off switch from externalization ('market') to internalization ('hierarchy'). In the latter case, an increasing pressure for internalization of the local market activities builds up and at a certain point in time the MNE exercises a wholesale internalization – confer previous Figure 1b.

Alternatively, one may envisage internalization as a stepwise, even incremental process, where effectuated internalization is synchronized with the underlying drivers of learning, growth, etc. In other words, the internalization unfolds as the need grows. Rather than making a dichotomous make-or-buy choice entrant MNEs combine make and buy modes until a 100% internalization eventually - if ever - is completed. By combining externalization and internalization in an optimal blend the entrant firm gets the best of both worlds. A practical example of this is found among international franchisers that, at any point in time, manage an optimal blend of franchised and company-owned outlets. Of course, when studying dynamics of international franchising, the internalization case is most often reversed: the franchiser undertakes a gradual externalization by diminishing the proportion of company-owned outlets (Lafontaine and Kaufman, 1992; Fladmoe-Lindquist and Jacque, 1995).

In a scenario of incremental internalization we implicitly assume away the occurrence of switching costs. Without careful planning, stepwise internalization is infeasible or excessively expensive. As a consequence, internalization is the initial and permanent mode (confer Figure 1a), or the internalization takes place as a single one-off switch in order to reduce switching costs (Figure 1b). However, real option and switching cost studies - see, for example, Kogut (1991) and Petersen et al (2000), respectively - suggest that entrant firms *might* be able to reduce switching costs through careful planning and managerial discretion. In the next section we discuss the role of ‘managerial discretion’ in the internalization theory.

3. Delineating the Managerial Scope of Internationalization

The dynamic drivers of internationalization outlined in the previous section have in common that they tend to be less susceptible to managerial influence. The market growth is to a large extent determined by exogenous factors; release of management resources depends on the scope economies of the MNE as a whole; experiential learning is determined by activities and elapsed time rather than by management; asset specificity is mainly on the part of the local operator inasmuch as the investments of the MNE are country rather than relationship-specific. Since the dynamic drivers are *underlying* drivers beyond the scope of management the benefits of gradual internalization are more or less *given* seen through the lenses of the MNE manager. Figure 4 depicts the marginal cost (MC) and benefit (MB) of the frequency of internalization, i.e. the number of internalization steps within a given time period in a given

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foreign market. The MB curve follows the same assumptions as in Figure 1a-c: Since the pressure for internalization increases proportionately with elapsed time of operations in a given foreign market the sub-optimization area divides into halves for every additional internalization step. Hence:

$$MB = \varphi\,(½)^{S-1} \quad \text{where}$$

MB = Marginal Benefit of one additional internalization step;

φ = Cost reduction obtained by introducing a single internalization step (confer Figure 2b);

S = Number of internalization steps within the observed time period.

The MB curve has a strong downward slope and goes asymptotic toward zero (the X-axis). In this scenario the benefit of more than five internalization steps is diminutive. The marginal cost of internalization (MC) is assumed constant.[3] However, the cost *level* across the internalization steps is assumed to be strongly influenced by MNE managers. Managers' potential influence on the MC levels is indicated by including three different horizontal cost lines in Figure 4 - MC, MC*, and MC**. The upper cost line, MC, does not intersect with the MB curve at any point simply because the potential additional renegotiation cost exceeds the marginal benefit at any internalization step – even the first, most beneficial. The MC* line intersects the MB curve at two internalization steps. Hence, the MNE will be better off making one internalization step and will neither be better or worse off by taking a second internalization step. The MB-MC** intersection is found at five internalization steps. The level of renegotiation costs in the MC* and MC** cases are significantly lower than in the MC case – indicating that the MNE managers have been much more successful in putting in place internalization options at market entry[4] and these options effectively curbs renegotiation costs later on. We will exemplify internalization options in the next section (section 4), but first we will discuss creation of internalization options in relation to management roles in the internalization theory as we know it today.

Internalization theory basically assigns three roles to the MNE management (see Figure 5): Firstly, the managers should decide whether the MNE should produce home and export to the foreign market in question or produce locally (see e.g. Horst, 1974). Secondly, the managers face a make-or-buy choice in the cases of localization advantages (Dunning, 1980). Thirdly,

[3] This simplified assumption reflects two opposite theoretical arguments: MC should be decreasing as a result of experience curve effects (Henderson/BCG, 1974). Conversely, MC should be increasing as a consequence of still higher asset specificity and, in turn, more and more costly haggling about the (growing) quasi-rent (Williamson, 1985). It is an unresolved empirical question whether the net effect is positive or negative.

[4] The MC includes pre-entry cost of negotiating internalization options. Potentially, contingent claim contracts may infer prohibitively high ink costs (Williamson, 1978; Hart, 1988). Hence, as a pre-condition for low MC the MNE management should be able to negotiate effective internalization options with a local operator at relatively low costs. See also next section for examples of relatively simple internalization options.

the managers have to decide the timing of internalization (Buckley and Casson, 1981) in the cases where the 'buy' choice precedes an internalization.[5]

---Insert Figure 5 about here ---

Seeing market exchange as the 'default option' the internalization theorists has first of all been occupied with the identification and analysis of various market imperfections that may result in internalization. Since the theorists have focused on the market efficiency analysis rather than the market power explanation (see e.g. Calvet, 1981) MNE managers have been assigned a 'neoclassical' role as omniscient *administrators* of market imperfections – and not *creators* of market imperfections[6]. In this perspective the managerial task in internalization theory is first of all to *observe* the various – mostly exogenous - factors of choice relevance, and only to a limited extent to involve one self in complex managerial discretion. Exact observation of internalization-relevant factors (such as market size and degree of asset specificity) univocally directs the right choice. Furthermore, the choices are relatively simple ones: Produce home or locally? Make-or-buy? When to internalize?

The suggested new management role in internalization theory – the creation of internalization options – is less susceptible to simple rules or choices and therefore lessens the deterministic flaw of the existing internalization theory. As will be demonstrated in the next section, an MNE may internalize a local operator in various ways – not only through acquisition of equity. Besides equity - assets, user rights, customer relations, and value added activities may be internalized step by step. The idea of creating internalization options is by no means new - see Rugman and Li (2005) for an overview of the real option concept applied to international investments – but the variety of areas in which these options can be put in place is hardly recognized in the IB literature. Real options are not only of relevance to internalization of

[5] As indicated in Figure 5 internalization theory may include two more management roles although one may consider these to be in the periphery of the theory, namely (a) the timing of replacing initial export with local production ('offshoring'), and (b) the specific mode of operation in case of a 'buy' choice (Contractor, 1990; Datta et al, 2002).

[6] Though, in some models based on the internalization theory MNE managers are assumed 'bounded' and not full rational, see e.g. Buckley et al, 2001.

equity, but also to assets, user rights, customer relationships and value added activities of the local operator. Also contributing to the managerial challenge of creating internalization options is the wide range of ways in which internalization options can be designed.[7] The new management role in internalization theory of creating internalization options is indicated by the box in the right-hand side of Figure 5. As emphasized earlier, the creation of internalization options potentially has a huge impact on the make-or-buy choice as well as the timing of internalization inasmuch as these – until now – relatively simple managerial choices suddenly become much more open-ended and consequently highlight the decision-making skills of MNE managers.

4. Examples of Internalization Options

How, in practice, would MNE managers stage an internalization *process*? As mentioned already, the managers' creation of internalization options at the local operators may pertain to acquisition of equity, but indeed also to other areas or aspects – including assets, user rights, customer relations, and value added activities. In this section we will briefly outline each of the five aspects and provide some practical examples of how MNE managers put in place internalization options. We start with internalization of equity.

Internalization of equity

Internalization of equity is well-described in the international joint venture literature; though, the focus has mainly been on institutional factors as determining changing ownership structures (se e.g. Gomez-Casseres, 1987; Hennart, 1988). In a study of entry strategies in emerging markets Meyer and Yen (2006) coin the term 'staged acquisition' to describe a stepwise taking over of equity of a local partner. The illustrating case is the 'staged acquisition' practiced in Poland and Vietnam by the international brewery *Carlsberg*. In these two emerging markets *Carlsberg* in several rounds increased its holding of equity shares of the local operator – at the same time being a licensee and a joint venture partner of *Carlsberg*. What was initially a minority stake was eventually turned into a majority stake or full acquisition. Such gradual acquisitions may be implemented via ad-hoc purchases of equity shares or through planned buy-out options. In our context the latter procedure is of course the

[7] An obvious source of inspiration to the design of internalization options is Williamson's discussion of various hold-up safeguards (Williamson, 1985).

more interesting. The case of *Nilfisk A/S* (producer of industrial vacuum cleaners) is an illustration of the consequences of *not* having equity buy-out options in place at market entry. In Spain - one of its major markets - the Danish MNE was only allowed to acquire a 10 % equity share of the local distributor, *Nilfisk Aspiradoras* – a very successful family-owned company. As a consequence of a general policy of majority control of its international distribution network the Danish MNE insisted on increasing its equity share; however, only to end up in a bitter legal dispute with its Spanish distributor (Petersen et al, 2000).

Internalization of assets

The entrant MNE takes control of (ownership to) more and more assets of the local operator. The acquired assets will typically be characterized by a high degree of specificity. As an example, the entrant MNE puts specialized machinery at the disposal of a local OEM supplier. Although not in an international context, the example of *General Motors*, as described by Monteverde and Teece (1982), is a good illustration of such 'quasi-integration'. Another (also domestic) example is the pharmaceutical company, *Novo Nordisk A/S* that lends suppliers specialized equipment needed for producing its insulin injection devices (Andersen and Rind-Christensen, 1999). The MNE may acquire very different kinds of assets at the local operator. As an example of internalization of human assets, Petersen (1996) reports of Danish exporting firms that are paying salaries to individuals in the local distributor's organization on the condition that these individuals focus entirely on sales of the exporter's products. An exporting firm reports that in order to 'persuade' the local distributor to allow this kind of 'headhunting' considerable overheads - 30 % of the wage paid to the specialized product manager - was extended to the local distributor. Hence, an initial negotiation of payment of overheads to the local operator in order to achieve acceptance of this human asset internalization would qualify as an internalization option.

Internalization of user rights (licenses)

The entrant MNE acquire – or rather, pulls back – the user rights originally handed over to a local licensee or franchisee. In the case where several user rights are licensed out, the entrant MNE may choose to negotiate the licensees separately and pull them back one by one. As an example, the Danish pharmaceutical MNE, *Lundbeck A/S* (producer of medicine for the treatment of diseases of the central nervous system) chose not to renew some of its licensing contracts with its Chinese distributors in 2006 as part of a new market strategy of upgrading its own presence in a rapidly growing market (Source: Personal communication).

Internalization of customer relations

Here, the entrant MNE takes ownership to more and more customers in the foreign market by converting them to "house accounts" (Coughlan et al, 2006). In this way local distributors are gradually phased out of the market. Dutta et al (1995) explain this dual distribution phenomenon by the principal's quest for better evaluation of local agents and by the principal's desire for posing credible threats of termination. In our case, the termination of local distributors is not kept as a threat, but is actually carried out over a period of time. The case of *Guess! Italia S.r.l.* is an illustration of such strategy. *Guess! Inc.* is an US producer of higher-end, fashionable jeans and various accessories. The US company has licensed the rights to market and sell its products in Europe to *Guess! Italia S.r.l.* After a management change in 2004 *Guess Italia* embarked on a policy of converting the larger and more important local customers (retailers) to 'house accounts'. The local distributors were compensated by a 7% commission of the wholesale to these 'house accounts' (Source: Personal communication with local distributors). In some of its larger national markets, such as Spain and France, the intention was clearly to internalize the entire business. The offered 'house account' commission can hardly qualify as an internalization option since *Guess! Italia* did not formulate its 'house account' policy at the time of the initial market entry. A true option would, for example, be an initial agreement in which it is stipulated that all local customers engaging in cross-national activities are to be converted to 'house accounts' against suitable compensation.

Internalization of value added activities

In contrast to the internalization of customer relations integration of value added activities is based on a division of responsibilities between the entrant MNE and the local operator (Petersen and Welch, 2002; Gabrielsson et al, 2002; Buckley and Hashai, 2004/2005). Effectively, this is a case of mode combination (Welch et al, 2007). The entrant MNE takes over more and more value chain activities in the local market. As an example, the entrant firm only performs upstream activities initially, but over a period of time the local distributor hands over downstream activities to the entrant firm (Williamson, 1992). During the 1990s the

Danish MNE, *Coloplast A/S* (a producer of wound-care and incontinence products for hospitals), practiced such a policy (Source: Personal communication). The policy was formulated as a three-step process where, first, the activities most closely related to end-customers (e.g. marketing) were internalized, then the ordinary sales activities, and lastly the physical distribution including warehousing and transportation.

5. Conclusion

Taking departure in Peter Buckley's 1993-discussion of the management role in internalization theory we conclude that – fifteen years after – there is still a considerable scope for developing the theory in the direction of becoming more prescriptive and practice-oriented. Our venture to develop the internalization theory has focused on *how* the internalization should be prepared and exercised when local outside agents are used as temporary entry modes. With insights from recent international business literature as well as from marketing and management literature we have elicited examples of best practice management of situations where the market transaction costs of using outside agents are negligible at market entry, but are growing over a period of time. The creation of internalisation options are key to attaining perfect concurrence between changing internalization advantages and the operation methods used in the foreign market. Internalisation options pertain not only to 'staged acquisition' (Meyer and Yen, 2006), but also to appropriation of assets, user rights, customer relations, and value added activities of the local operator. As such, our study suggests a new research agenda where the understanding of 'internalization' is widened significantly.

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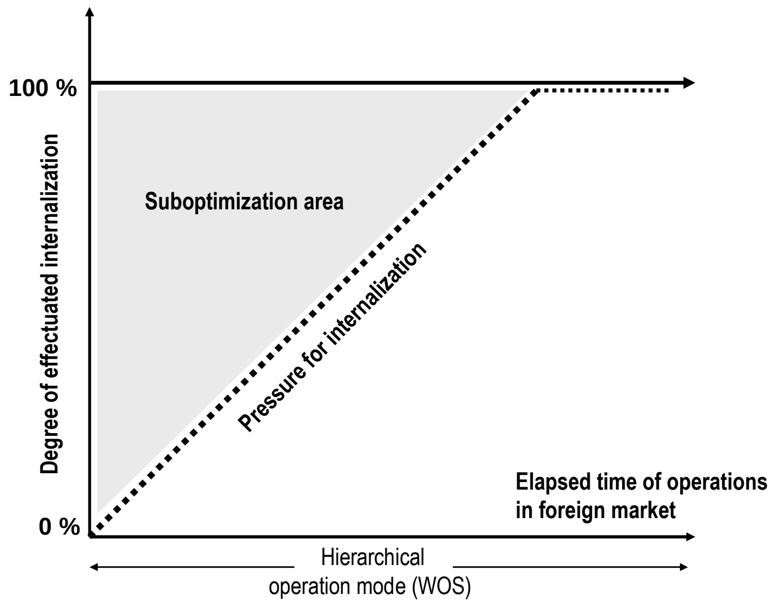


Figure 1a: Different scenarios of internalization: Immediate internalization.

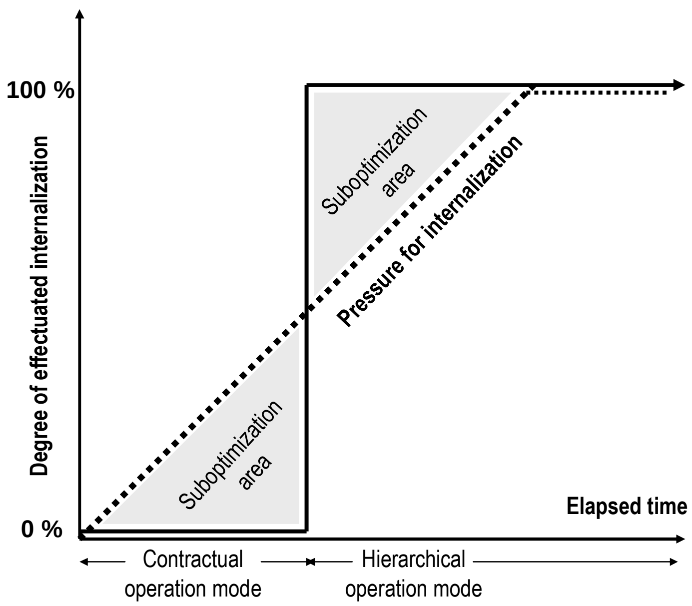


Figure 1b: Different scenarios of internalization: One shift scenario

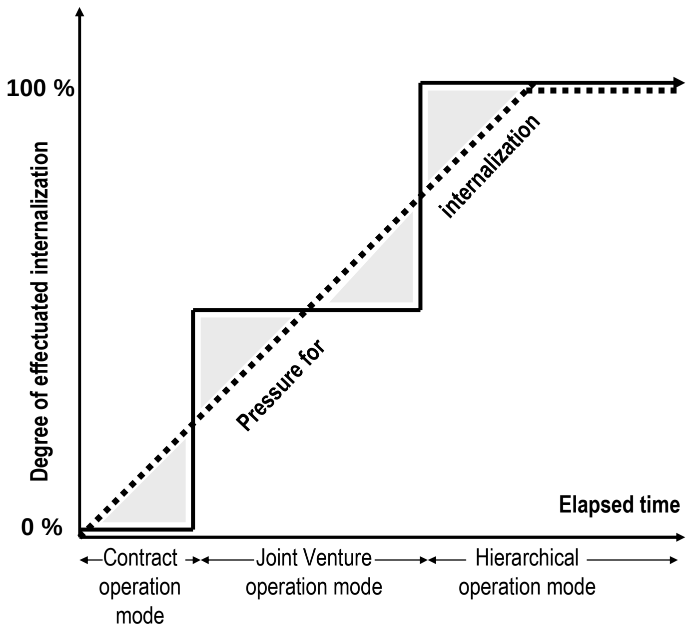
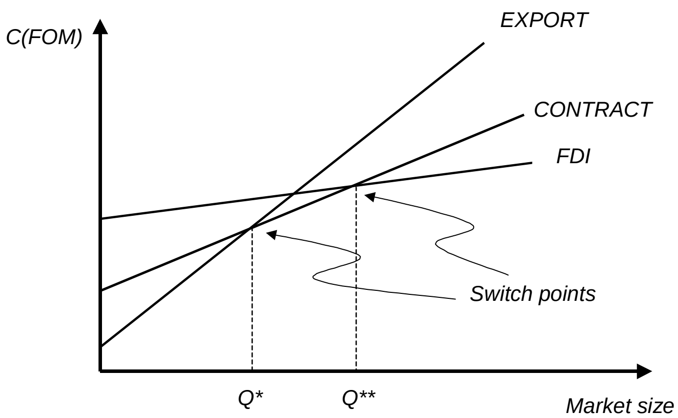


Figure 1c: Different scenarios of internalization: Two shift scenario



Adapted from Buckley & Casson (1981)

Figure 2: Market growth as a driver of internalization

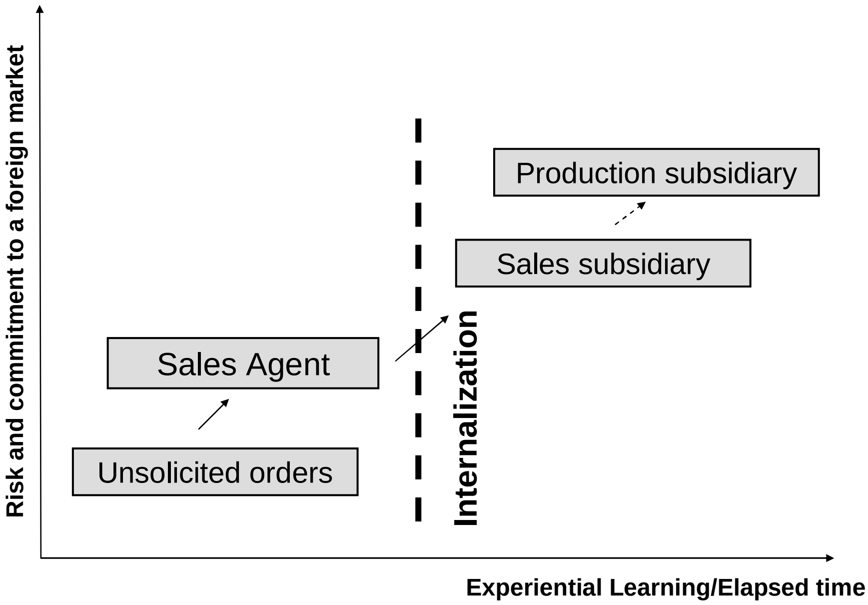


Figure 3: Experiential learning as a driver of internalization

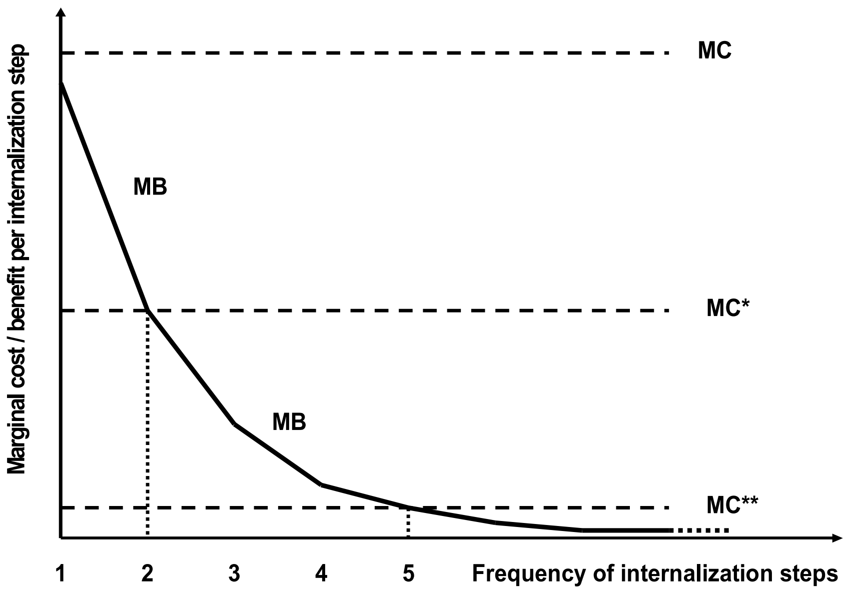


Figure 4: Delineating the management scope in the internalization process

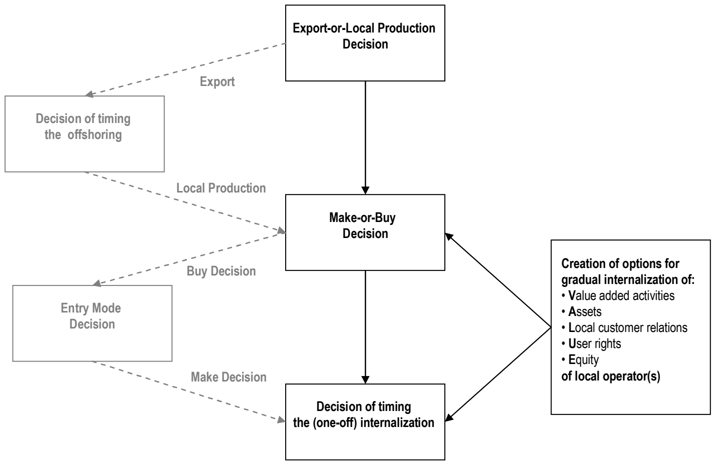


Figure 5: Existing and 'new' management roles in internalization theory