International Business Policy: Main Streams of Literature and Emerging Agendas

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Abstract

The better understanding of the interconnections between MNE activities and the objectives of policy makers is under the radar of scholars at least since the 1960s. In this paper we review the extent and emmerging prespectives on, and approach to, international business policy and particularly, we explore the importance of policy on outward internationalization based on three theoretical branches of economic literature - rational, behavioural and institutional economics. From this literature emerges the rationale for government policy to promote the internationalization of domestic firms is to secure returns to the domestic economy that firms alone are unable to appropriate. In fact, this idea lies on the argument that without public intervention, the level and speed of internationalization would fall below what would is thought best for domestic society.

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1. Introduction

The mechanism through which policy measures exert their effects is undeservedly neglected or even ignored within international business research. As somewhat of a Cinderella topic, there is a legacy theoretical deficit. This has contributed to a reliance in policy design upon custom and practice rather than scientific evidence. In this paper we review the IBP literature and present some approaches for government policy that seeks to promote the internationalization of domestic firms, namely, small and medium enterprises (SMEs). There is, we argue, a dual gap, a gap in the theory of how policy intervention intersects with the SMEs internationalization process (IP) to give effect to policy intervention (PI) by governments, and a gap in practice, a lack of knowledge on the part of policymakers of any quantitative and predictable relationship between policy intervention and its effects on firms internationalization. We harness relevant contributions to theory to produce a new approach to explaining the mechanism of policy intervention and, using this as a basis, to explore how policy intervention might be made more effective.

Home country support measures towards internationalization (HCSMIs) are designed by policy-makers supposedly with the intention to address deficiencies originating at the level of the firm, market or institutional levels that interfere with the ability of firms to respond to profitable international opportunities (Cuervo-Cazurra, Maloney & Manrakhan, 2007; Wright, Westhead & Ucbasaran, 2007). Therefore, these measures aim to increase the involvement and performance of domestic firms in foreign markets, on the premise that this intervention will serve the private interests of firms and thereby, by aggregation and dragging effects, the national interest (Glaum & Oesterle, 2007).

Incentives have become popular in government circles, and have been widely applied in a wide range of countries (Spence, 2003; UNCTAD, 2001). Although there is governmental and increasing academic interest in the effectiveness and efficiency of public incentives in achieving their goals, the rationale underlying the use of this support has attracted little scientific scrutiny. This contrasts strongly with the burgeoning literature on the influence of institutions upon firm's behavior (Chetty, 2015; Madrian, 2014; North, 2016; Zucchella, Palamara & Denicolai, 2007). It is reasonable to say that, while International Business research has produced theoretical accounts of the internationalization of the firm, it has not to date produced a satisfactory understanding of how policy intervention actually exerts its effect; that is, the process of action of distinct policy measures upon the internationalization process itself, starting with the initial decision to internationalize and finishing with the evaluation of the internationalization impacts.As a result, although widespread, policy intervention to promote the internationalization of domestic firms lacks a sound theoretical basis.

The conceptual instrument here to understand the international business policy mechanism (IBPM) is the operating system that results from the home country support measures to promote internationalization (HCSMIs), oficial incentives provided through a home country's law to encourage the internationalization of domestic firms.

These may comprise: (1) non-financial incentives, and (2) financial incentives, while each may be implemented through soft law or hard law. Soft law usually refers to quasi-legal instruments which do not have any legally binding force, or whose binding force is somewhat "weaker" than the binding force of traditional law, often referred to as hard law (Abbott, Keohane, Moravcsik, Slaughter & Snidal, 2000). Non-financial support involves the flow of

non-monetary resources aimed at upgrading firms' capabilities. It typically consists of the provision of information and technical assistance, e.g., to reduce international information asymmetries, to lower the avoidable risk attaching to investment, and to mitigate the cost of firm's outward internationalization. Examples of the typical instruments employed include: logistical support for participating in trade fairs or state missions, training and consulting services, informational services, support for hosting trainees in foreign firms, and support through the development of international investment agreements.

Financial incentives, afford firms access directly or indirectly to capital at lower cost, through applying a lower valuation of risks. Financial incentives either afford firms direct access to capital at a lower cost, e.g., a lower cost of borrowing, or afford finance with which to purchase specific required resources, e.g., finance for insurance, i.e., indirect. The rationale behind these incentives is the need to strengthen the capabilities, and productive capacity of SMEs to explore the broad range of foreign investment activities (Lall & Narula, 2004). Examples include support through investment and credit insurance and mutual funds, venture capital, fiscal benefits, financial packages, preferential credit conditions through protocols with banks, and support for acquiring or developing brands.

Research on the impact of policy intervention, both scientific and non-scientific evaluative studies of policy effectiveness, generally focuses on the uptake of policy measures, relying on metrics of policy intervention, such as, the impact on domestic firms' sales and employment (Gil-Pareja, Llorca-Vivero, Martínez-Serrano & Requena-Silvente, 2015; Naidu, Cavusgil, Murthy & Sarkar, 1997; Seringhaus & Botschen, 1991; Wilkinson, Mattsson & Easton, 2000). In addition studies typically investigate concrete motives that cause policy to exert an effect upon firms; for instance, to reduce costs and uncertainty, to increase sustainable competitive advantage, as well as an appraisal of the broader degree of success in terms of alignment with national policies (UNCTAD, 2012; Vedung, 2009). In direct contrast to the planned outcomes, the findings may uncover what is IBPM like, base opportunism, i.e., the exploitation of incentives by firms for purposes other than that intended under the public support program concerned.

2. A Rationale for Home Country Support Measures Towards Internationalization

China's Go Global policy in the early 2000s was one of the first objective and declared policy making action to promote outward investment from emerging countries. The case for policy to encourage outward internationalization by firms operating domestically is a result of, in the broadest sense, benefits to the economy which would not accrue if internationalization were left to the market alone. It is reasonable to suppose that economies that introduce policy to promote a relative gain (to foreign economies) in the outward internationalisation do so entirely for selfish reasons - that is, to promote domestic economic growth and welfare (Besley & Persson, 2014). It is, however possible, that there are circumstances in which interests beyond the home country are also important. One category may be to foster development in less developed economies, or partially so (Moran, 2009). Another possibility is where the economy concerned is pursuing regional integration with other economies (Cuervo-Cazurra,

Maloney & Manrakhan, 2007).[1]

The baseline justification for promotive policy is that firms face barriers to profitable internationalization, for which the market is unable to supply remedies (UKTI, 2014). Thus, the standard theoretical idea is that there are identifiable sources of private inefficiency that can be internalized by social means. In particular, small and medium enterprises (SMEs) are, for some reason, or reasons, unable to identify fully the profitable opportunities that exist in foreign markets, or face some barriers that prevent them from acting effectively to take advantage of these opportunities. Additionally, very few firms have the interests of their home economy at heart, meaning however well private efficiency is served, there will be some social inefficiency.[2]

From this discussion alone, it is evident that policy intervention in this sphere should require information on any combination of, or all, the opportunities that are available to SMEs, and the internationalization barriers that they may face, which are external or internal in nature (Aghion, Fally & Scarpetta, 2007; Azzimonti, 2011; OECD Working Party on SMEs and Entrepreneurship, 2009; UKTI, 2014). Private sector solutions to these barriers, in the form of, for example, international trade consultants, international trade intermediaries, trading houses and, increasingly, firms that organize international supply chains, mean that support is available for firms whose products can most readily be matched with markets abroad. However, governments routinely intervene with blanket policy to promote internationalization.

The theoretical basis for this lies not only in the putative existence of non-appropriated returns to the firm, but also of returns to the economy, or society more widely which, in the absence of policy intervention would be forgone. These returns to the economy, includes other firms and in this case we should consider the case for foreign market access spillovers (Bloom, Schankerman & Van Reenen, 2013; Chudnovsky, López & Rossi, 2008; Mancusi, 2008). Foreign market access spillovers (FMAS) is a particular type of external benefit to firms that flow from the international activity of earlier internationalized firms. Such spillovers suggest that support to firms to internationalize can result in a multiplier effect, whereby the early internationalizers stimulate internationalization by follower firms (Plakoyiannaki & Deligianni, 2009).

[1] In this case, the interests of the domestic economy are more tightly bound with those of its neighbors. In this paper, we afford particular attention to the European Union, as it should be expected that, if there are benefits that lie beyond the member state's promotional policy, then a difference in policy provisions might be perceived between policy towards third countries and policy towards fellow member states (comprising the regional economic integration, or REIO). Furthermore, the underlying rationale for regional integration might be expected to justify a coherent pan-REIO promotional policy towards internationalization, both within the economic area, and with third countries. However, for inward investment, there is no evidence of preference given to investment from other member states compared with third countries, with all member states never invoking their REIO exception clauses under the individual member state bilateral investment treaties with third countries. In effect, the playing field is completely level as between third country and member state firms when it comes to investing within the EU.

[2] For joint-stock companies, particularly those in which ownership and control is largely separate, the fiduciary duty of the directors is to the wealth of the shareholders, regardless of where they reside. The larger question of whether foreign ownership is likely to create a greater division between private and national (domestic) social values is beyong the scope of this paper, but is a legitmate focus for research, taking the question of whether foreign ownership matters, a step further.

Another point that should be considered is the parallel between innovation and internationalization and the impact of innovation on internationalization (Roper & Love, 2002; Sterlacchini, 1999). Research and development (R&D) is demonstrated to have a positive impact upon multifactor productivity (Griffith, Huergo, Mairesse & Peters, 2006; Hall & Van Reenen, 2000). Therefore, governments intervene to support innovation in the expectation that innovation will have a positive impact on employment and knowledge creation, result in lower rates of enterprise failure and improve national competitiveness (Almus & Czarnitzki, 2003; Criscuolo, Narula & Verspagen, 2005; Falk, 2007; Meuleman & De Maeseneire, 2012; Nelson & Nelson, 2002; Storey & Tether, 1998).The standard economic rationale for underinvestment in R&D activity, meaning a socially sub-optimal level of investment, which is the result of two distinct types of market failure: spillover effects arising from the imperfect appropriability of the social returns from innovation, and financing gaps induced by asymmetric information between enterprises with investment projects and potential suppliers of capital. This asymmetry causes uncertainty over expected returns, so attenuating the rate of investment (Martin & Scott, 2000; Meuleman & De Maeseneire, 2012).

On the basis of existing theoretical and empirical work, the premise in this paper is that these benefits of internationalization remain unexploited as an outcome of economic and social organization - specifically, the nature of decision making within the firm, the imperfections of markets, and the institutional inefficiency. Therefore and following **?**, we focus on precisely these areas to develop our theoretical argument and propositions. Internationalization policy is the ideal application ground, as it comprises an area of policy making in which the social and the private dimensions have been poorly associated theoretically, and in which observation has produced a range of results, frequently conflicted (Knill & Lehmkuhl, 2002). However, in order to investigate the rationale and benefits of domestic firm internationalization, we need to have to do step back and now turn to international business theory, in which changes at each of the levels (firm, industry and country) that affect an economy's trade, investment and non-equity position with other economies have been extensively theorized and investigated empirically.

2.1. International Business Theory and Policy

The standard model of international business theory is encapsulated in the eclectic paradigm, or Ownership, Location and Internalization (OLI) approach developed by John H. Dunning (Dunning, 1977, 1980, 1988). Dunning's framework is well suited to analysis at the level of the economy, as it was conceived as an extension to the theory of international trade, and subsequently incorporated into formal models of international economics (e.g., (Krugman, 1980, 1983; Helpman, 1984, 1985). The framework is eclectic, and the contributing theories themselves address research problems of the competitive advantage of firms, the location of value adding activities, and of using internal as well as external markets for the allocation of resources (Dunning, 2000).

Even within the OLI schema the policy dimension remains underdeveloped theoretically. Dunning (Dunning & Rugman, 1985) experimented with assimilating policy frameworks into the eclectic paradigm, notably the Environment-System-Policy (ESP) framework (Koopmans & Montias, 1971), which is prior to the embracing Institutional Theory (North, 1971, 1978). The institutional and policy dimensions of the ESP framework could, in Dunning's thinking,

be layered on top of the OLI framework, so preserving the logical structure of the eclectic paradigm. Michael Porter's diamond of competitive advantages (DCA) (Porter, 1990) replicated the eclectic paradigm's arguments on location as qualities of countries conferring some monopoly power, thereby introducing the idea of strategic policy action at the level of the economy. Though the ESP or DCA frameworks itself did not provide a theory of policy intervention, each of the "technological determinants of productivity change" impacts on Dunning's categories of O, L and I. The productivity advantages identified in these categories thereby shift. The potential is opened up for the creation of economic impacts, in the circumstances that there are imperfections in the market solution. In this way, technology change (in the broadest sense) is capable of creating the need for an institutional and policy response. We consider here only increases in productivity, although decreases may also require a policy response.[3]

Changes in productivity advantages (CPAs) that arise in the Ownership category stem from technological innovation which, by its nature is, in principle, capable of being applied productively in any location. CPAs that arise in the Location category stem from technological changes that affect, or have the potential to affect, the productivity of locations. This includes innovation that is idiosyncratic to location consequent to the application of new scientific technology, but also subject to being influenced by demographic change and climate change. CPAs - that arise in the Internalization category are wrought specifically by technology change immediately creates an externality in that the firm should grow, to cater to the potential to work the productivity advantage, but may not be able to do so if factor markets are imperfect. Such constraints are likely to affect small firms in particular, that are least able to resolve the externality so created either fast enough or extensively enough. For this reason pro-internationalization policy, applied through HCSMIs, focuses on the smaller and entrepreneurial firm sector.

The Internalization category in international business theory is central to determining whether the social good is served by the replacement of an external market by a market internal to the firm. When an internal market is created, as is implied by the creation of the firm (Coase, 1937) this is only to serve the private benefit of the shareholders, not necessarily to serve any external benefit to society. It is only in the special conditions of there being a complete set of markets, and of perfectly competitive conditions in these markets that the theoretically maximal social good is served. It is necessarily true that when internalization occurs, that an external market must be imperfect, as a perfect external market cannot be improved upon in terms of static efficiency. We argue that the existence of markets as institutions is a rejection of stasis.

The purpose of markets is to provide a dynamic mechanism for dealing with new information and change. Once instituted, the market (i.e., the institution of markets) is an

[3]A further complication is related to issues of market power which, may require a policy response in the domestic domain, namely in terms of regulation, but not in the international level. This is because national welfare is distinct from global welfare and the international distribution of welfare, which may opens the issue of the aggregate international business position of economies (AIBPE), (gross inward, outward and net) i.e., AIBPE could be depicted by the percentage of assets owned or controlled by domestic firms in foreign economies, in outward terms; yet in inward terms, by the assets owned by foreign firms in the domestic economies, decisions are often made on information and understanding out of these spheres of theory.

innovation that has a natural (though not necessarily intended) application to ideas, and abstract goods in general. This introduces the dynamic serving of the public good through innovation, for which theory requires that there be some degree of market imperfection. This implies that, in any conditions other than stasis (in which case markets would not be required) the possibility of internalization is intrinsic to the existence of markets.

The economies of the firm, that is, economizing on having to establish prices in less efficient external markets, suggests that the internal market may bear more relation to socially-based forms of economic organization which predate the institution of markets. In these circumstances, adaptations of natural social organization - notably corporate culture - along with socially-defined roles in which the incumbents are substitutable, then assume importance for the efficient internal functioning of the firm. The term "administrative fiat" to describe the internal command structure of the firm has been coined to encapsulate this form of internal economic organization (Dunning, 2003). The implications of this schema is that for policy to exert real effect upon firms, identifying the relevant form of reasoning - specifically socially-based reasoning (Kahneman & Tversky, 1979; Smith, 1962). Policy acting upon firms is not seeking to operate upon external markets based on the price mechanism stripped of social logic. With technological change, the parameters of O, L and I, change. How firms respond to this, and to policy intervention, is analyzed using theories of firm decision making and behavior. The way firms respond to policy is through adaptation of normal decision making and behavioral processes, and therefore the theories discussed below are explored to generate propositions on how policy exerts traction.

Each of the major approaches to decision making rest on assumptions. Generally, it is through the relaxation of assumptions that theory becomes more closely associated with observation, and the number of anomalies reduced. We need to consider this relaxation because if the complexity of the problem is sufficiently low, then even the most assumption-ridden theory may be the most efficient to the task. However, as complexity rises, hidden assumptions come to blight our understanding of how decisions are made.

The sparse writings on international business policy have, to date, predominantly focused on inward investment rather than outward internationalization. Whether inward or outward, it remains true that to exert an effect on firm internationalization, policy must intervene appropriately within the firm to have a grip on the decision making process, however, this mechanism has remained relatively unexplored. Therefore, to investigate how this traction is created, we turn to mainstream economic theory, where this mechanism is treated, broadly within the domains of institutional, behavioral and rational economics.

2.2. Rational Economics and its Application to International Business Policy

Here we investigate the role of mainstream economic theory in drawing out the rationale behind different accounts of decision-making underpinning the development and implementation of HCSMIs. In particular, what might be the role of these theories in providing a basis for government intervention in domestic firms' process of internationalization? Or, in other words, what is the role of economic theory in understanding international business policy?

The dominant framework for understanding the international organization of the firm is transaction cost economics (TCE) (Casson, 2015; Rugman, 2005; Teece, 1986). Within

this approach, missing markets and market imperfections are held to explain the inefficient allocation of resources, and so failure to reach the theoretical maximum social welfare. For any economy, at any point in time, there will be misallocations of resources from the social optimum, that is, in a static sense. While these may be amenable to correction by one-time solutions, for example, a subsidy, or a transfer of resources, it is in the dynamic dimension that continually created misallocations recur. This is a normal outcome of a market economy with technological change.

The theory of decision making in rational economics is clearly pitched at the problem of explaining the behavior of the natural individual and, by analogy, the corporate individual. Given a set of preferences within utility theory, rationality implies a decision making process that invariably follows a set of established rules to maximize personal utility (Brink, 1986). Neoclassical economics, from which rational choice theory springs, is a meta-theory, i.e., a set of implicit rules for constructing satisfactory theories, and was generalized by Alfred Marshall (1890).[4] In his Principles of Economics, Marshall (1890) explains the determination of prices through the intersection of supply and demand curves, described in different market periods. There are three assumptions for Marshall, that: (1) individuals and firms have rational preferences between outcomes; (2) individuals and firms, respectively, maximize utility and profit; (3) individuals and firms act independently on the basis of full and relevant information. The assumptions of this approach are that the rules are established, presumably the same for all individuals, though we do not know how they are established, how do they relate (Edgeworth, 1890) and that the data or facts on which rational evaluation is made are known with certainty. It offers a default basis for understanding decision making. This economic approach portrays the individual as a cold rational calculator making decisions with information collected and computed to evaluate the value of all actions that fix all aims. This idea has its roots in the writings of Aristotle (5th Century BC) and later developed by Hobbes (1651) that describes the relationship between man's nature and the structure of society, portraying humans as rational agents who seek to maximize power and act according to self-interest, because acting otherwise would threaten their self-preservation, and Quesnay (1758), who argues that innate self-interest is the primary economic motivator of all activities.[5]

Later, Smith (1776) argues for a system of natural liberty whereby individual effort to achieve the private good is the producer of the social good. This system envisages the need

[4]Veblen (1900) coined the term "neoclassical economics" to refer to the development of theory using marginalist principles arising from the work of Jevons (1871), Menger (1871), and Walras (1874) offering functional form and, therefore, solutions to unresolved questions of equilibrium within classical economic theory developed from Smith (1776) and Ricardo (1817).

[5]Leviathan is the name of a monster in the biblical book of Job, and for Hobbes the state is the "great Leviathan", which is but an "Artificial man"; though of greater stature and strength than the natural, for whose protection and defence it was intended; and in which, the sovereign is an Artificial souls, as giving life and motion to the whole body. The state is thus a cruel, artificial construct, but is necessary nonetheless for the sake of the protection of its citizens. The problem, he tells us, is that we are inclined to appropriate to ourselves the use of that things in which all others have a joint interest. He argues that rule by an absolute sovereign nonetheless involves a social contract with people. The Leviathan has the merit of being the first fully worked-out treatment of how social contract between individuals can provide the foundations of legitimate political authority (Garvey & Stangroom, 2013).

for only a limited role of the state in the economy on account of the assumption that individual effort is sufficient for the realization of almost all latent value for the social good. The theoretical innovation of Smith (1776) is in connecting productive effort and utility at the individual (or private) level with welfare at the social level. However, the first deep philosophical debate over these ideas was developed by Marx & Engels (1848), who argued that the inequities of the market economy amounted to an exploitation of the working class by the owners of capital. Thus, according to Marx, a proletarian revolution was required to replace capitalism with what he saw as the next stage in economic development: a socialist state in which the means of production are owned by workers, and an eventual abolition of private property. Given the absence of complete and efficient markets, Marx's ideas challenge the prediction that individual effort is sufficient to achieve the maximal social good (Marx & Engels, 1848; Marx, 1867). However, more pertinent to our present purpose is that the emphasis in market-based economics upon the individual economic agent that, when scaled up to the level of the firm, invites the mistaken presumption that atomistic competition will always prevail.

The role of the firm in this discussion comes with the theory of the existence of the firm (Coase, 1937) demonstrated that imperfections in intermediate goods and services markets, previously neglected and therefore implicitly assumed away, implies that the size of firm was indefinite, although subject to "Decreasing returns to the managerial function" (Coase, 1937, 394). The theory of the firm introduces the possibility of considerable scale, and so of final market power exploited for private gain at the expense of social welfare. Market imperfections appear intrinsic to economic activity with technological progress to seek productive gain. As the quest for such gain necessarily implies making decision that go beyond what is already known, the assumption of complete knowledge on which to base decisions cannot be upheld. It is therefore necessary to theorize on how uncertainty is handled, as this is the natural state rather than an exception.

Management within the firm can be thought of as an adaptation of human social organization, and there are strong reasons to expect that management and business behavior is rooted in the principles governing normal social processes and the creation of social structures in order to handle uncertainty, and to aid decision making (Simon, 1947). This includes agency, defined by McGaughey, Kumaraswamy & Liesch (2016) as "Purposive action by individuals, firms, coalitions, and other actors which is directed at the construction of institutions". These, in turn, then govern human and corporate action. Drawing on Lawrence & Suddaby (2006, pp.219-220) and McGaughey, Kumaraswamy & Liesch (2016, p.874), we can describe the action of agents upon institutions as "institution work", defined as the "practices of individual and collective actors aimed at creating, maintaining, and disrupting institutions" taking place within an organizational field itself obeying a set of institutionalized rules Lawrence, Suddaby & Leca (2011, p.52). The existence of these structures, and their function, is directed toward the problem of incomplete information for human survival and, by extension, the survival and performance of the firm.

2.3. Behavioural Economics and its Application to International Business Policy

A premise of Behavioural Economics is that it is prohibitive to gather together and evaluate all the relevant facts needed to calculate the costs and benefits of every action, which implies

an assessment upon the eventual outcome. Before this body of work, economic theory was very much limited to theorizing within the utility paradigm of homo *oeconomicus* in which humans are assumed to be motivated by self-interest and capable of making rational choices. Inherent unknowability of future events and the uncertainty this produces is heightened by the prevalence of technological change. Contemporary society is predicated upon the continuous search for, and generation of, productive gain, and it is a characteristic of a market economy that it, and its agents, are specialized in order to deliver this (Acemoğlu, 1996). Furthermore, in order to deliver greater gains from the widening of economic specialization and cooperation, national economies are now highly open systems within the global economy, thereby adding to complexity and uncertainty (Milner & Keohane, 1996). It follows that, on internationalization the firm faces a marked lack of availability of knowledge about foreign markets, and such knowledge as is available is only so at higher cost (Eriksson, Johanson, Majkgard & Sharma, 1997).

Theory has been developed during the latter half of the 20th century to account for why people, in practice, often take quick decisions based on past experience, habit and rules of thumb. The mechanism of this reasoning is the product of human ecology, largely fashioned by evolution before markets came to dominate the creation of value for society. The outcome is poor decisions by individuals, owing to limits in ability, importance and time (Simon, 1947). The co-existence of short and long-run goals is especially difficult to resolve using conventional economic theory, as uncertainty increases exponentially into the future from a fixed standpoint.

In an attempt to link to mainstream economics, Herbert Simon (1957) presents a set of mathematical models of human behaviour, the predictions of which lead him to argue that people are not able to acquire and interpret all the available information on every relevant topic and so, while their decision making behavior is rational, it is based on limited information and understanding (Simon, 1957b). This is given the name of "bounded rationality". The modern human mind is ancient in design, see for example the Broadbent's (1987) "Filter Model of Attention" which explains why we can only listen to one voice at once (Broadbent, 1987). The artefacts of this are in the form of decision making within the firm, are asked to deal with complex and inter-temporal decisions, on a regular basis, that would have, in an earlier time, been settled by natural selection and population ecology (Dunbar, 1992, 1998).

Bounded rationality conflicts with conventional rationality in relaxing the assumption of full information available to the individual. With some adaptation, the idea can be applied within the context of the firm (Simon, 1947, 1957b; March & Simon, 1958). Here, Cyert & March (1963) derive three important limitations that flow from criticism of simple rational choice. First, deals with a particular set of decisions (e.g., price, or production) that are viewed within conventional rational economics as slavish functions of a few 'catch-all' variables (e.g., demand, or costs). Second, in working at the level of total market supply and demand curves, conventional theory is employing aggregation as a tactic to produce deterministic results. Third, there is no attention to, or interest in, the actual process through which individual firms reach decisions (Cyert & March, 1963).

Based on Simon (1957b), Cyert & March (1963) develop a behavioral approach taking the firm as the basic unit of analysis. Through emphasizing the process of decision making, their model seeks to predict more accurately firm behavior with respect to price, output and resource allocation decisions. March & Simon (1958) explore the social psychology of people

living and working in an organizational environment by framing the rationale for bureaucracy in terms of cognition. They argue that hierarchy, long seen as simply a manifestation of a chain of command, serves an information-processing function directly analogous to that of a computer program. The functional purpose of bureaucracy is to factor complex decision problems that are beyond the capacities of individual decision-makers into smaller parts that can be solved by human agents, and then aggregated back up through the hierarchy, much as computer programs factor problems into sub-routines, to produce an output. Therefore, the firm establishes an infrastructure for analysis and decision making that enables better informed and more rational decisions to be made than any of its individuals could make unaided, to better serve the profit motive of the firm.

Departing from the paradigm of expected utility (Schoemaker, 1982), or profit, based on the individual rational agent model, the BTF avoids aggregation as a device to produce deterministic outcomes, in favor of process-based explanations and micro-predictions "Especially with regard to the internal allocation of resources and the process of setting prices and outputs" (Cyert & March, 1963, p.16). The BTF also departs from received Organization Theory focused on the anatomical structure of the firm (Taylor, 1911; Chandler, 1962), enabling a better understanding of how fundamental decisions in the firm are taken, e.g., price, output, and resource allocation (Cyert & March, 1963). According to Gavetti, Greve, Levinthal & Ocasio (2012) the BTF was intended to create an organizationally rich and reasonably descriptive account of firm behavior as a basis for explicating organizational adaptation to environmental and market processes, in particular, integrating organization theory and market power theory. The cognitive foundations of the behavioral theory of firm (CFs-BTF) are the following: (1) satisficing behavior, i.e., individual decision makers do not maximize, they search through the available alternatives until an acceptability threshold is met; (2) searching, i. e., individuals lack complete knowledge or have bounded rationality; (3) rules [of thumb], standard operating procedures and status quo, i. e., when uncertainty is significant individuals resort to coping mechanisms (e. g., standard operating mechanisms).

A further major development of this branch of literature was prospect theory (PT), which considers the potential value of losses and gains rather than focusing solely on the final outcome, which must remain uncertain (Kahneman & Tversky, 1979; Tversky & Kahneman, 1981). Behavioral Economics offers a more accurate description of individual behavior and decision making than the expected utility paradigm, drawn from a better understanding of human judgement and decision-making under uncertainty produced by developments in cognitive psychology. Once integrated into economic science, it transformed economics from a non-experimental science into a field where experiments became reality. It also provides a path to improved understanding of how the organization of the firm better fits with the nature of human decision making, towards explaining the behavior of the firm itself. However while Kahneman and Tversky (Kahneman & Tversky, 1979; Tversky & Kahneman, 1981) mainly focused on decisions by individual agents, another main branch on behavioral economics was developed by Vernon Smith, who had extended the BTF to multiple actors, through experiments based mainly on management decision-making games (Smith, 1962, 1965, 1976). This involved interaction between agents in specific market environments, either in innovative experiments within competitive markets (Smith, 1962) in tests of different auction forms (Smith, 1965, 1976; Coppinger, Smith & Titus, 1980), or in the design of the induced-value method (IVM) (Smith, 1976). A major outcome of this branch of literature is known as

"Auction Theory" (AT), again contributing to the field of experimental economics.

It is a logical prediction of behavioral theory that the capacity of firms to recognize and act upon productive and profitable market opportunities may be constrained, thereby contributing to the incompleteness of the set of markets, and so limiting the effectiveness of market competition, as fewer firms may realize their potential to enter markets and to compete effectively. In the international sphere limited information, but also limited in terms of capabilities of the representative firm, will result in forgone profitable opportunities to more effectively exploit knowledge and comparative advantage, so contributing to social welfare. Indeed, within international business theory and associated empirical research, the endemic nature of the lack of knowledge of foreign markets and their institutions is theorized as the cost or liability of foreignness, at least since Hymer (1960), Zaheer (1995) and Zaheer & Mosakowski (1997).

Finally, we may say that the Behavioral Theory of the Firm has been relevant to the parallel construction of understanding of incentives within political economy (Laffont, 2001). It is a common perception that policy makers behave rationally, but within certain limits imposed by limited information, time and human ability to see every pattern of a problem Simon (1957a). Therefore, theory applies both to firms as agents of competition, and to policy makers as the agents of societies' ability to achieve social value.

2.4. Institutional Economics and its Application to International Business Policy

Institutional economics has a long tradition in the mainstream of economy. Veblen (1900) in his "Preconceptions of Economic Science" argues for the primacy of institutions in explanations of economic performance. Later, Commons (1934), yet in an institutional vein, argues that the economy is a web of relationships/institutions between people with diverging interests and the government should be the mediator between conflicting interests. It is within this web of relationships that according to Groenewegen, Spithoven & Van Den Berg (2010) institutional economics concerns itself with explaining the different ways in which individuals transact and how do their transactions are coordinated.

The idea that institutions provide the incentive structure of an economy stems from the extensive work of Douglass North on economic performance. North (1990) defines institutions as "humanly devised constraints that shape human interactions". These constraints are the "rules" of the game, and appear in both formal and informal guises. Human transactions include: the market transactions, which take place in the market between individual buyers and sellers; the managerial transactions, relationships between one person in control and one being managed; and the political transactions, which take place when governmental decision-makers exert their legal authority to determine how wealth should be distributed (Groenewegen, Spithoven & Van Den Berg, 2010). Thus, institutions are not only the rules that facilitate transactions reducing environmental barriers but also the reference basis of transactions in an increasingly complex world. Institutions include laws, customs and traditions of a society (North, 1990). Therefore, economic agents, i.e., buyer, sellers, employers, employees, decision-makers and citizens, work within the bounds of (these) institutions when they sell, buy, or work. If "good institutions" promote economic and social progress, "bad institutions" hamper economic progress. Linking this idea to Commons (1934), we may say that good institutions improve the efficiency of an economy, but there remains the missing

point about the role of institutions in promoting the value of markets. This was a deficiency treated by Avner Greif, who made use of game theory to analyze the historical development of institutions that allowed trade to develop, specifically through contract enforceability linked to economic institutions (Greif, 1992, 1993, 1994).

At the root of theoretical research on policy intervention is the quest to unify private with social values. According to theory in the domain of economics, if there were to be a complete set of markets, policy intervention to bring private and social values together would be unnecessary, as any externalities would be removed by the creation of new markets through market-making entrepreneurship leading to the entry of a sufficiently large number of firms to eradicate all unpriced transactions. External social costs and benefits only arise because there are missing and imperfect markets.

Precisely how policy towards firms exerts real effect is somewhat of a "black box". The central objective of the firm we take as being the goal of profit maximization, that is, to maximize the wealth of the firm's shareholders. The agents of the firms - the managers - have an absolute fiduciary duty to the shareholders to achieve this goal, subject to the intervention by government to bring private values into closer approximation to social values. In this simplified, stylized, account, our research question then becomes "How, precisely, does this intervention actually achieve the desired effect?" This is an important question because, to date, there is no clear theoretical account of how this policy effect comes about, and yet the effect of policy intervention relies upon there being a reliable mechanism through which policy is able to work "through the agency of its managers" upon the actions of the firm.

The theories of transaction cost economics and of institutions, and the relationship between them, has been the subject of enquiry (see Roberts & Greenwood (1997). The common theoretical root is the innovation of the institution of markets in human pre-history. But North is not alone in linking institutions to transaction costs. In fact, it was Ronald Coase that firstly helped us to understand the significance of transaction costs and property rights for the institutional structure and functioning of the economy. Coase (1960) argues that if we lived in a world without transaction costs, people would bargain with one another to create the same allocation of resources, regardless of the way a court might rule in property disputes. Later on, in his 1991 Nobel lecture, Ronald Coase returns to this point with two fundamental insights. First, he describes a fundamental insight as being "To realise that there were costs of using the pricing mechanism" Coase (1937, p.2) and his second that "If we move from a regime of zero transaction costs to one of positive transaction costs, what becomes immediately clear is the crucial importance of the legal system in this new world" Coase (1960, p.4), i.e., the importance of the legal system and transaction costs are positively related. Here Coase is pointing to the necessity of the creation of an institution (the legal system) in order to support the functioning of markets and, in doing so, he outlines the nature of the relationship between institutions and transaction costs, and between institutional theory and transaction cost economics. Coase also identified that structures to govern expectations are necessary in a world of transaction costs, in order to promote cooperation, and that these structures, or infrastructures, need to be homogenised and rolled out, rapidly, effectively, and over a large area to benefit from returns to scale in widening the locus of cooperation.

The institution is the infrastructure (e.g., the legal system) while the policy is in the precise provisions that run on these institutions. An analogy might be the value-added services

that run on a telecommunications network. However, this account, which sets out the nature of the relationship between institutions, transaction costs and, by extension policy (e.g., extending Coase's example of the effect of a sales tax on the scope of the firm, Coase (1937, p.393) does not elaborate on the mechanism through which the desired effect is realized in the behavior of the firm - i.e., the mechanism of policy traction.

It is here that we make the theoretical connection between the guidance of behaviour by institutions and by culture. The concepts of the "Rules of the game" and of "Legitimacy" are cited widely in the literature but, while intellectually accessible, do not set out the mechanism through which behavior is influenced. In this paper we argue that the original way of regulating behaviour through common culture is progressively inadequate to operate effectively over large distances, and large populations, being liable to fragmentation. Furthermore, culture is unable to fulfil the requirements of a market economy and, as a consequence the social value of culture is hard to fully measure since it is a dynamic and variable issue, i.e., as the degree of reliance on market coordination rises in the economy, the role of culture must diminish, and the importance of institutions must grow.

The logic behind this is that, although there are different types of culture, including professional, and corporate culture, the prevalent form is nationally-imprinted culture (largely imprinted from birth), i.e., common to the majority of citizens. National culture, in particular, and culture in general is therefore slow to adjust via natural social processes, and so is inadequate to sustaining a system of markets of the scale required by a modern economy. We argue that, as the purpose of markets is to maximize the efficiency and rate of growth of productive cooperation caused by broadly-defined technological change, that only the social innovation of institutions is able to service a developed market economy. Institutions and specific policies might therefore be viewed as "fast track" versions of the cooperation yielded by social cohesion, in particular by culture, as both a social tool for living and for working. The major economic contrast between culture and institutions as means of enabling cooperation is that institutions require recurrent expenditure of resources to maintain them and their ability to meet the needs of the market economy, while culture requires a considerable sacrifice of time budget, concentrated in early life. Institutions are also more readily deployed to govern corporate organization.

The function of institutions, then, is to provide a framework for cooperative behavior over an extended economic space and over extended time, in order to bring about certainty on a larger scale, in order to maximize productive cooperation. This is at the root of the relationship between transaction costs and institutions identified by (Coase, 1991). Institutions are themselves a social innovation, in a line of descent from the innovation of culture through several generations. The departure of the human species from ecological success based on natural selection of physical attributes alone, i.e., to include cognitive attributes organised socially is tantamount to institutional innovation. As we have argued, cooperation and exchange inevitably becomes based less on social relations which are slow to change and are geographically limited, and more on markets supported by institutions (Alesina & Giuliano, 2015). This avoids failure to establish sufficient certainty over intention and outcome to promoting cooperation. As Coase noted, the existence of transaction costs - whether within an external or internal market - creates the need for institutions, and this is the source of the "crucial importance" of transaction costs for governance (Coase, 1991). Transaction costs caused by informational and interpretive uncertainty of Weber & Mayer (2014) create

impediments to cooperation, truncating or delaying it, or both. Common institutions have the effect of enabling people, and firms, to modelling their "own model", rather to share a model. It is for this reason that institutions, by default, are circumscribed by political sovereignty, and in turn circumscribe sovereignty itself. The significance of this for policy is an emergent property of the "legitimacy" of the institutions and the gain that is perceived by the decision makers within the firm, for the purpose of the firm from the adherence to the institutions and to the policy. To the extent that there is a deficiency in legitimacy to achieve the desired policy objective, then there is a need for incentivization in order to create the desired response to policy.

The creation of the firm has two components. First, it replaces, or pre-empts, external markets with internal markets. Second, although designated as markets, these internal markets themselves are often, in effect, a return to non-market, or social, forms of organization that characterize societies without firms. Institutions are required within the internal economy of the firm as well as in the external market economy in order to govern cooperation. And the internal "market" though often referred to as such, may not resemble the external market that closely. To some extent there is a natural reversion to a reliance on social relations as, to the extent that the internal institutions of the firm are inadequate to the functioning of the internal market, a greater burden will, by default, be placed upon socially-based means of cooperation and coordination and, once the investment in institutions internal to the firm can be sustained, typically with the growth of the firm, then social cohesion can be replaced by internal regulatory coordination. There is therefore a symmetry, in that firms replace the institution of intermediate markets by non-market institutions, first of culture, if a small firm, then of regulation, if a large firm.

As a principle of transaction cost economics is that, in equilibrium, the internal market will only be employed in place of an external market when the internal market is the more efficient, we can infer that inefficiency in the internal market is tolerated only when the external market is still less efficient.

3. Conclusion

This paper explores the mainstream ideas and emerging agendas of international business policy recurring to the role of three branches of economic theory to explain the rationale basis for government intervention in domestic firms' process of internationalization. According with rational economics, the individual always engage in rational behaviour and its decision making process results in a optimal level. So, within this branch of literature, pro-internationalization policy could be framed within a cost-benefit analysis of the national welfare, since it is distinct from global welfare and the international distribution of welfare.

However, it is impossible to gather together and evaluate all the relevant facts needed to calculate the costs and benefits of every action. Bounded rationality conflicts with conventional rationality in relaxing the assumption of full information available to the individual. Pro-internationalization policy is often justified as necessary to cover the lack of knowledge about foreign markets and other difficulties that firms may encounter during the internationalization process. So, this insight is important to better understand the policy maker position towards internationalization as the agents of competition and as agents of societies'

to achieve an optimal social value within firms' environmental network of actions.

Thus, institutions provide a framework for cooperative behavior over an extended economic space and over extended time, in order to bring about certainty on a larger scale, in order to maximize productive cooperation. Here the cooperation between economies and the coherence of (and between) policies are essential to find the precise provisions that run on these cross-border institutions. The idea that the rationale for government policy to promote the internationalization of domestic firms is to secure returns to the domestic economy that firms alone are unable to appropriate is like to understand the autarky in trade and do not include the open economy. We believe that higher levels of cooperation and some specific public intervention, will improve the level and speed of internationalization what would is thought best for domestic and foreign societies.

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