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The Contribution of Internalisation Theory to International Business: New Realities and Unanswered Questions

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Abstract

This paper sets out the importance of internalisation theory to international business research and practice. It examines the context against which the theory has been developed, the environmental conditions in which the multinational enterprise has evolved and the phenomena that the theory has explained. It also examines the challenge to the theory of "unanswered questions". These include governance, location theory, dynamics, networked multinationals, innovation, entrepreneurship and the role of risk and uncertainty.

Key words

Internalisation theory
Multinational enterprise
Internationalisation of the firm
Innovation
International entrepreneurship
Governance

1. Introduction

In examining the contribution of internalisation theory to international business, this article sets out not only to show the importance of the theory to research on international business but also the crucial interaction of the theory with international business practice. The theory is examined in terms of its context, its environment and the key phenomena it was intended to explain, and to predict. This piece contends that interaction with real world business phenomena has been a major feature of internalisation theorising and this has been a key strength, enhancing the power of the theory.

This paper interprets "context" to mean the social, political and economic conditions in which successive versions and revisions of the theory were set. "Environment" is taken to be the most important external (to the firm) conditions under which theorising about the multinational firm occurred. "Phenomena" are the key largely macro events, trends and circumstances that the theory was intended to explain. As these phenomena largely arose in the dynamic global business world, this article pays particular attention to the (two-way) interaction between theory and evolving global business practices.

The first part of the paper examines the ways in which internalisation theory has responded to the new realities of a changing global economy from the 1970s onwards. It does so by examining what was written at the time to reflect changing realities using broad timespans of circa 1976, "the eighties", "the nineties", "the early 2000s" and 2015 to reflect key pieces by progenitors of the internalisation school [1] - see Table 1.

The paper then goes on to pose some 'unanswered questions' although it cannot resist putting a question mark after this phrase and attempting to answer, at least partially, some of these questions.

2. Internalisation theory and the changing global economy

2.1. "Initial conditions" – the 1970s and before

The growth of the multinational enterprise as a dominant institution in the world economy was recognised following the end of the Second World War by political, social and academic attention to its growing salience. Significant theoretical and conceptual development was initiated by Stephen Hymer's 1960 thesis (published Hymer 1976) and the parallel pioneering work of John Dunning (1958) and Raymond Vernon (1966).

The overwhelming political reaction was suspicion and sometimes fear of the potential dominance of large firms that spanned national boundaries, and, it was surmised, national controls. This hostility to MNE was particularly in evidence in

[1] This paper takes a narrow view of internalisation theory, not directly addressing Williamson's Transaction Cost Economics (TCE) agenda (Williamson 1981, 1996), nor John Dunning's Eclectic Paradigm (Dunning 1979, 2000). The eclectic paradigm included internalisation as one of its key elements – with location and ownership (OLI), but did not directly contribute to internalisation theory per se.

what were then termed LDCs (Less Developed Countries) and by international organisations attempting to defend the interests of “small countries” against “large firms”. Particularly vehement in this respect was UNCTAD which had concerns about the exclusive control of key technologies (felt essential for development) by MNEs (UNCTAD 2014). The changing attitude of UNCTAD towards MNEs (Transnational Corporations (TNCs) in UN-speak) is a case study in itself on changing attitudes (influenced by theory) towards MNEs (UNCTAD 2014, Buckley 2010).

At this stage MNEs were seen as unitary, monolithic companies. The standard MNE was Western (Japanese MNEs were included in this), privately owned, manufacturing, largely uninational in ownership, finance and culture, and capitalistic. Expanding this stereotypical view took time, and a theory that transcended these artificial constraints.

2.2. The 1980s

Internalisation theory was not new. Its progenitor, Ronald Coase, published the seminal piece ‘The nature of the firm’ in 1937, but the ideas had their origin in his undergraduate work considerably earlier. Oliver Williamson (1975) developed his ‘markets and hierarchies’ approach – building on foundations from the Carnegie School, almost simultaneously with Buckley and Casson’s (1976) application of the Coasean approach to MNEs. Earlier work had included McManus (1972) and it was quickly followed by the similar approaches of Hennart (1982) Rugman (1981) and Dunning (1979).

Internalisation theory cast the MNE in a different light to that shed by Hymer’s monopolistic competition approach (see also Caves, 1971, 1974, 1980,). Buckley and Casson (1976) showed that internalisation had both positive and negative welfare affects – perfecting markets versus concentrating power but, crucially, that the key factor in the growth of the MNE was not market power (although that may be a consequence in certain circumstances) but innovation. The shift to the dynamic innovatory capability of internal markets and the notion that foreign direct investment (FDI) was the firm’s internal substitute for the external diffusion of knowledge (inhibited by the market imperfections for knowledge and the problem of “buyer uncertainty” (Buckley and Casson 1976 pp 38-39)) transformed the understanding of MNEs and the appropriate policy prescriptions. It is interesting that the policy aspect of the Future of the Multinational Enterprise has been under examined, compared to the explanation of MNE growth, now adopted as a foundation of international business theory.

Internalisation theory opened the artificial boundaries of understanding of the MNE – small firms, non-Western firms, non-manufacturing firms and crucially non-hierarchical, non- monolithic firms not necessarily vertically and horizontally integrated, came within the ambit of the theory. Alternatives to the MNE (Casson 1979) were explored – such as the licencing option (wider than just technology transfer in internalisation theory). Critical to this understanding was the approach to international trade in intermediate goods and services. Much of this trade took place within firms but across countries – giving an added complexity to standard trade theory and to business strategy because this trade took place at internal ‘transfer prices' rather than between separate agents. The policy development and management issues of this are profound and remain to this day.

Concern remained as to how weak, fragmented countries could develop in circumstances where MNEs control knowledge, trade, resources and talent. Attempts were made to boost the capacities of host countries to negotiate with MNEs. Critically, advanced rich countries began to concern themselves with their relative "competitive" standing and Porter's influential The Competitive Advantage of Nations (1990) focused academic and policy attention and Government resources on boosting "competitiveness". This is somewhat ironic, since a focus on the intertwined nature of international trade in goods and services and on "global commodity chains" had shown that interdependence, not stand alone competitiveness, was growing and that a global system was emerging.

One aspect of increasing the power of host countries was the promotion of joint ventures between host countries and foreign investors. Theoretically, this was one part of a key advance in international business theory – the explanation and prediction of the "foreign market servicing strategy" of MNEs – the set of choices of locations and modes (generically exporting, licensing and foreign direct investment) based on ownership decision and logistics. Analyses of modes of doing business abroad – location plus externalisation/internalisation decisions - gradually became more sophisticated in parallel with conceptual and theoretical advances and progressions in practical international business management in MNEs.

2.3. <u>The 1990s</u>

The course of the 1990s saw the development of the flexible MNE. Increasing sophistication of management, increased cultural understanding by firms, greater openness of markets and technological advances, notably information technology led to much wider options being open for MNEs. The ability of MNEs to move mobile factors (technology, skills, knowledge, information) and to combine them with a widening array of fixed resources (opening markets, labour markets, natural resources) created new combinations across the globe. Management in multinationals needed to have wide information sources, information management systems and knowledge creation abilities. To make the best use of (potential and actual) foreign resources in a dynamic world, MNEs had to be flexible and to devise management systems that maximised their returns on knowledge (Buckley and Casson (1998a), (1998b), Buckley and Carter 1999).

2.4. <u>The Early 2000s: The Global Factory</u>

The recognition of globalisation as a phenomenon was a factor increasing throughout this period. The world's production system was being conceptualised in terms of global value chains, competition to attract FDI was intensifying and so too were MNEs increasing use of outsourced activities (using the market alternatives) and offshoring these elements. Crudely, the generic strategy became "outsource operations, internalise knowledge" (Buckley and Carter 2004). It became logical therefore to envisage MNEs as key players in a global systems view (Buckley and Hashai 2004, Casson 2000). The MNE centred aspects of these developments is picked up in the conceptualisation of 'the global factory' (Buckley and Ghauri 2004).

2.5. A plurality of modes and locations

The rise of China is a story that cannot be ignored in an analysis of globalisation. Far outstripping the rest of the BRICs (Brazil, Russia, India, China and (sometimes) South Africa), China moved from being the location of choice for routine production activities, to being a major powerhouse of increasing value-adding activity to becoming an important foreign direct investor. Chinese, Indian and other emerging country MNEs became major players internationally and potentially a challenge to conventional theories of FDI – such as internalisation theory.

However, internalisation theory proved capable of answering the challenge. The general theory of internalisation (least cost location plus internalising markets up to the boundary where the costs outweigh the benefits of further internalisation) incorporates a number of "special theories" in which context these factors apply particularly strongly in carefully specified conditions. One such special theory incorporated Chinese MNEs particularly well in the early 2000s – development of international activities where the key imperfection is in the host country capital market (Buckley, Clegg, Cross, Voss, Xin and Zheng 2007). These imperfections channel cheap capital to potential foreign investors who therefore (under Government guidance) can purchase assets and resources abroad.

The exceptionalism of emerging country MNEs is not the whole story of globalisation however. Worldwide competition for activities and world trade in tasks subjects the internal activities of MNEs (all of them) to the pressure of the market. Accounting systems such as 'mark to market' encourage this. The pressure of the market (outsourcing, or potential outsourcing) and the rise of new locations (such as the IT, business processing and other service activities of India) led to an expanding 'market for market transactions' (Liesch et al 2012) that enforces international pricing (and quality) pressures on even the most insular companies. Global competition faces all activities and coordination costs within companies have to respond in order to maintain the integrity of the internalised bundle of tasks that is the firm.

As Hennart (2009) has pointed out, managers in MNEs have to make a purposeful effort to bundle their resources with "country specific" complementary assets and this is a key focus of practical management research. This is closely related to approaches that emphasise managerial perceptions of transaction costs (Buckley and Chapman 1997) that are currently yielding exciting findings on the way that managers take decisions – and how far these conform with theoretical predictions (Buckley, Devinney and Louviere 2007).

Globalisation means interdependence (a two way relationship) and should be distinguished from "modernisation", the term that development began with in the 1970s, which is a one-way absorption of western values (Hunt 2014). The rise of a multipolar economy, centred on cities, gives rise to new forms of theorising with a more nuanced view of locations, of geographic space and place and a move away from the endemic methodological nationalism of international business research. (McCann, P. and Mudambi, R. (2004, 2005), Mudambi (2008), Beugelsdijk, McCann and Mudambi 2010, Beugelsdij and Mudambi. (2013).

The remainder of the paper examines the current challenges facing internalisation theory.

3.Unanswered Questions?

There are essentially three forms of internalisation theory as applied to international business – this is to take a cross section or "stock" view of a developing corpus of knowledge – extant in 2015.

The first approach is the firm-based view where internalisation and location theories are applied to explain the existence, growth and strategy of the (multinational) firm. This is the most usual interpretation of Buckley and Casson (1976) and Hennart (1982).

The second approach is to apply internalisation theory to global value chains where the 'make or buy', externalisation decisions are evaluated under this rubric. It most closely sits within the firm-based view to give a 'global factory' (Buckley, 2009, 2011, Buckley & Ghauri 2004) or 'flagship firm' (Rugman and D'Cruz 2000) conceptual framework where a focal firm (orchestrating firm (Hinterhuber 2002) or chain leader (Gereffi 1999, 2001) set the overall strategy and associated, satellite firms (often SMEs) support the network leader (Eriksson, Nummela and Saarenketo 2014).

The third approach is the global systems view which examines the global economy and analyses the breakdown of that economy into constituent firms by examining activities, boundaries and locations. Proponents of this view (Buckley and Hashai (2004), Casson (1995b) (2000)) see the other two approaches as subsets of this overarching explanatory framework when restrictions or simplifying assumptions are brought to bear on the general model. It can further be claimed that the global system view is akin to general equilibrium analysis whilst the other two are partial equilibrium analyses.

The essential unity and compatibility of these approaches derives from their common Coasean heritage (Coase 1937) and the fact that they are nested analyses, the first and second fitting within the third like Russian dolls. Moving between these three levels of analysis requires consistency and explicitness of assumptions and an unwavering focus on the appropriate unit of analysis, with consistent use of empirical data. An analysis of the role of marketing in multinational enterprises showed the value of the global systems approach (Buckley and Casson 2011). The explicit introduction of marketing into the internalisation theory of the multinational enterprise extends the power of the theory by enabling a comparison of marketing-led and technology-led MNEs and highlighting the benefits of collaboration between them. It facilitates the analysis of outsourcing, in particular of R&D and shows the importance to marketing led firms of owning product rather than facilities helping the understanding of "hollow firms", "flagship firms" (Rugman and D'Cruz 2000) and "the global factory" (Buckley and Ghauri 2004, Buckley 2009, 2011).

When the author of this paper referred to internalisation as "a concept in search of a theory" (Buckley 1983 p 42) it was because, after the publication of The Future of the Multinational Enterprise (1976), internalisation was combined with a location theory and was essentially a theory of the firm. The reach of the concept was potentially wider than simply the firm (or any organisation for that matter). Subsequently the authors developed a theory of the global production system, with internalisation at its heart (Buckley and Casson 1996, 1998a, Casson 2013). The coexistence of internalisation as a central concept in the theory of multinational firm and the global systems view requires clarification and has led to some unresolved issues in international business theorising.

In terms of the internalisation theory of the firm – issues of governance and location theory are in need to development, the question of dynamics and predicting the direction, speed and process of internationalisation is unsatisfactory at least in some theorists' eyes. The development of a theory of the (unitary) firm into a theory of networked multinationals has raised new questions as have the associated questions of innovation - and dispersed innovation. As for all theories, the issues of risk and uncertainty and their conceptual treatment are problematic. The integration of internalisation theory with theories of entrepreneurship, despite the valiant efforts of Mark Casson, remain unresolved in much of the literature. Finally, integration and consistency between the different levels of internalisation theory – explaining the firm, networked multinationals and the global system view is essential.

This leaves a rich set of unanswered questions, unresolved issues or problems in the literature to be addressed. These are tackled below under the following headings.

1. Governance of the (multinational) firm.
2. Location theory.
3. Dynamics.
4. Networked Multinationals.
5. Innovation.
6. Risk and Uncertainty.
7. Entrepreneurship.
8. Firm, Network, Global System.

3.1.<u>Governance</u>

"For forms of government let fools contest, what'er is best administered is best" (Alexander Pope, Essay on Man. 1994 originally published 1734)

Altering "government" to "governance" may be an accurate view of many analysis' views of the organisation of business, but internalisation theorists do have much to say on which form of governance is best for (multinational) enterprises.

First, it is not correct to say that internalisation eliminates governance costs. The argument is that in certain contexts, governance costs are reduced by internalisation, but the only proposition that is necessary is that overall costs of organising any particular activities (or transaction) are reduced (or increased) when the firm grows (shrinks) relative to market organisation. Governance costs are a part of overall costs of organising an activity – and if other costs are reduced (production costs, marketing costs) then it is perfectly possible that governance costs, taken alone, may actually increase in an internalised market. Examination of "pure" governance costs is therefore entirely legitimate – the problem is the separate estimation or measurement of pure governance costs.

Teece (1983) approached this problem by separating “governance costs” from “production costs”. This approach has two severe problems. First, as any perusal of the costs of benefits of internalising markets show, production and governance costs are conceptually inseparable. Second, the measurement of governance costs, and any close proxies, is difficult.

Buckley and Strange (2011), following Teece (1983), analysed the internal transaction costs associated with the governance and organisation of MNEs. The costs of information acquisition and transmission, the costs of coordination and the costs of aligning the interests of the different (and changing) stakeholders in the MNE provide interesting hypotheses on the current and future configuration and governance of MNEs (Buckley and Carter 1996). Information, coordination and motivation costs can be explored and can provide plausible answers to issues of configuration and performance. More on the internal microfoundations research avenue is likely.[2]

The internalisation approach to governance structures can be illustrated by its approach to financing the corporation and more specifically, by its approach to the external debt: equity rate in corporate financial structure. Debt is externally raised and therefore is the “market solution”. Using the Williamson (1988) argument that rather than regarding debt and equity as financial instruments, it is better to analyse them as different governance structures, equity can be regarded as an internal supply of funds. Departing from the Williamson arguments, pure internalisation theory regards internal supply of finance as being allocated by an internal capital market to competing “projects” as represented by individual subsidiaries, for example. Capital is fungible within an internalised capital market. There are also information asymmetries between the two forms of financing as the corporation has more information about the likely profitability of its projects than does the external capital market. The value of debt to the company is that it has an option value and can often by converted to equity (this is not true in the opposite direction). Debt financing at fixed rates is attractive to companies if they estimate the profitability of a debt funded project to be above the interest rate on the debt.

We can therefore propose an internalisation approach to governance as reflected in the capital structure of companies.

3.2. Location Theory

International business continues to suffer from methodological nationalism. Locations in large countries (USA, China, India) are vastly different on any of the key indicators that international business uses as locators – costs, distance, culture. Much more relevant than competition between nations is competition between cities – competition that is intra-national as well as extra-national (Beijing versus Shanghai, and versus Dehli). As well as ‘place’ (the specific location), investors and theorists need to account for ‘space’ (heterogeneity and the distance between locations).

[2] A Special issue of Global Strategy Journal is currently mooted on precisely this topic.

Location needs to include complementarity (with existing investments) and scale. Spatial structure includes accessibility and agglomeration effects – the former is seldom included in modelling, sometimes the latter is explicitly included. Thus correct accounting must be made for speed – increasingly a key factor in international competition because locations differ on alternative measures of speed of access and exit.

When networked multinationals are examined, the roles of route and spatial continuity come into play. Discussions of (global) value chains require an analysis of transport modes and innovations in intermodalism such as containers and the "internet of things". We can conceptualise a value chain as a functionally integrated network, linked by transactions where each successive node involves the acquisition or organisation of inputs for the purpose of adding value (based on Rodrigue et al (2013)). Internalisation theory is perfectly placed to provide the theory of such changes, in detail as well as in general, concerned as it is with transactions, modes and fixed nodes, acquisition and greenfield ventures.

The challenge is to advance the location theory aspects of internalisation theory without over complication and descent into description.

Combining issues of governance with distance gives an intriguing take on problems in MNEs. The combination of headquarter's control of governance with operations at a distance gives rise to potential unintended consequences when the negative externalities of international operation occur at a distance from the key decision makers. Lack of monitoring or surveillance of "distant" operations can lead to problems of governance which may reflect badly on the firm as a whole and have negative effects in the home country. It is arguable that there is a strong internalisation aspect to such issues if monitoring of externalised or even quasi-externalised operations are the source of the problem. Are outsourced operations subject to less control than are internalised ones (subsidiaries).

3.3. Dynamics

There is an, often unwitting, division in internationalisation between the Uppsala model (Johanson and Vahlne 1977, 2009) explaining "internationalisation" and internalisation theory explaining multinational enterprises. This is sometimes parlayed into "dynamics" (the process of internationalisation) versus "statics" (established MNEs).

The Uppsala approach explains the sequence of internationalisation – by countries entered. The deepening of involvement in each market entered by intensity of mode (licensing → joint venture → FDI for instance) is explained by internalisation theory on the basis of Buckley and Casson's (1981) "timing of foreign direct investment" paper. This is taken up in the next section.

The sequence of internationalisation in the classic Uppsala 1997 paper was predicted by entry into countries with increasing "psychic distance' (Johanson and Wiedersheim-Paul 1975) from the home country. The inference is that an internal process of discovery and learning enables the firm to expand by learning from its past investments. The inputs of market knowledge and market commitment as decisions have outputs that feed into the next round of decisions, thus creating a dynamic process. Time lags between rounds are unspecified. Commitment decisions also reduce the perceived uncertainty surrounding further foreign ventures (building on Aharoni's (1966) work). Negative feedback is also possible, inhibiting future internationalisation. Indeed, it appears to be that "reaching the tolerable risk frontier" is the barrier beyond which the firm will not grow. This frontier moves as investment in relevant knowledge reduces uncertainty and makes previously "too risky" investments feasible. The combination of economic effect and uncertainty effect at any given time determine current, and planned, internationalisation. The authors acknowledge that "scale" is the only variable that affects the economy of the market operations and that technology is ignored.

The prototypical Uppsala firm therefore is technologically static and is seeking to spread its fixed technology – or fixed goods and services bundle - to world markets. It enters on the basis of scale and psychic distance, the latter factor being a risk screening proxy, determined by the firm's knowledge of the foreign market. As foreign markets grow in scale, and the firm builds knowledge, so the firm will internationalise sequentially. This sequence is constrained by the firm's internal resources, which leads to 'small steps'. The Uppsala model has therefore become a model of "gradual" or "incremental" internationalisation, appropriate for uncertain, naïve, possibly first time (Buckley, Newbould and Thurwell 1988) or capital constrained investors. It is not a template for "born globals "(Knight and Cavusgil 2004). In fact, the internalisation approach with its "big bang" view of internationalisation – globalisation – is far more appropriate for these, generally high-tech, start-ups.

The "revised" Uppsala model (Johanson and Vahlne 2009) updates the language and orientation of the model, emphasising its network elements but does not introduce technological change or innovation. The root of uncertainty now is "outsidership" in relation to the relevant network, rather than psychic distance. The "knowledge creation" that is added is to recognise new knowledge developed in relationships - not innovation in products, process or service. Focus on networks arguably provides some convergence with "global factory" forms of internalisation theory and Johanson and Vahlne (2009 p 1462) suggest that organisational learning are discussed in both theories.

Is the Uppsala approach a special case of internalisation theory? No. It is not possible to combine the two approaches because of incompatible assumptions – on technology, on knowledge, on risk. The Uppsala approach has little, if anything, to say on markets and it is this that renders the two approaches incompatible.

It is ironic that an approach that assumes that firms are technologically static (Uppsala) is regarded as more dynamic than the internalisation approach which is predicated on the innovatory nature of firms. Firms grow, in the internalisation view, because of their predilection for absorbing the fruits of R&D investment (Buckley and Casson 1976 pp 34-35). Foreign direct investment is a substitute for the dissemination of knowledge on the market because of well known imperfections in that market. Internationalisation and (domestic) diversification are substitute growth trajectories. (This is analysed in detail in Buckley and Casson (2007) where internalisation and internationalisation are contrasted with Penrosean growth and diversification).

Nowhere is there a time dimension in the Uppsala model of internationalisation. This reinforces the view of gradualism in the sequential entry predicted by that model, driven by psychic distance costs and market scale. (Johnson & Vahlne 1977, 2009). This contrasts with internalisation, where the timing of market entry for FDI is specified by the interaction of fixed costs (the cost of establishing the mode) and variable costs (costs of expanding in the market) in any given market (Buckley and Casson 1981).

Because there is no time dimension, nor indeed any time – dependent variables in the explanatory framework, Uppsala theorists can explain the direction of internationalisation, but not its timing.

One additional way of incorporating dynamics into the theory is to examine the entrepreneurial function within MNEs. It is largely unrecognised that a great deal of the exercise of entrepreneurship takes place within MNEs. The creation of new products, processes and organisational forms illustrates entrepreneurship but so too does the gradual improvement of all these elements. Concentration on spectacular 'one-off' innovations is to focus on only the tip of the iceberg of the entrepreneurial function. This goes along with seeing entrepreneurship as the sole preserve of small firms.

Mark Casson has made the study of entrepreneurship one of the key themes in internalisation research. He shows that the exercise of judgement and the management and control of information and information costs are key aspects of entrepreneurship, and, as such, are exercised in firms of all sizes and dispositions (Casson 1995b). Entrepreneurship, too, is an important link with business culture in theorising. (Casson 1995a). A link with economic growth and development is derived when we consider that some national cultures foster entrepreneurial behaviour, and others inhibit it (Buckley and Casson 1991). Links between internalisation, the exercise of entrepreneurship and culture are exciting avenues for future research.

3.4. Networked multinationals

No man is an island, and nor is a firm. Firms are surrounded by markets and are famously "islands of planning in seas of markets" (Robertson 1923). Their external boundary relations and relationships are interfaces with markets, yes, but with the other firms operating in those markets – suppliers, distributors, agents, partners. Some firms also interact with individuals and households as customers, rather than other firms. These network relationships are complex and bargaining and negotiation, as well as "pure" market interactions surround the firm. This is the essence of the network - and theorising around network relationships is critical, given that multinationals are often focal (or flagship (Rugman and D'Cruz 2000) or orchestrating (Hinterhuber 2002)) firms, central to a "global factory" structure that involves a constellation of independent firms (Buckley 2011, Buckley and Ghauri 2004, Eriksson, Nummela and Saarenketo 2014). These dynamically shifting boundaries are a major focus of international business research (Hennart 2009) and have been since the beginning of the subject (Casson 1979, Caves 1980).

A plurality of research methods and paradigms have focused on networked firms. In the internalisation approach, networks emerge as coordinating mechanisms – like the firm and the market (Casson 2000). Crucial issues within networks are control of information and – in production and particularly service networks – control of quality. Networks provide a context for the exercise of entrepreneurial judgement in a volatile environment and thus networks provide a background for the analysis of entrepreneurship, culture and trust (Buckley and Casson 1988). This is the background for the global systems view of international business (Casson 2000) Buckley and Hashai 2004,).

3.5.Innovation

Patents are a limited measure of firm-specific advantages. Patenting happens because the knowledge patented is potentially valuable to other companies. Patents represent potentially re-deployable knowledge and patent protection (of up to 10 years) represents a quasi-monopoly for a specific time and region. Like other forms of FSA, therefore, they can be defined only for a specific range of space and time. They are often taken as a proxy for a firm's underlying innovative capacity. More evidence is needed on the (varying) relationships between patenting and innovation.

The rule for acquisition of technology has become "Invent it, swap it or buy it" (Economist 2014). This means in-house innovation, asset exchanges (as in pharmaceuticals) or building an intelligent network to acquire technology or to buy the companies that do the innovation.

It should not be forgotten that the internalisation of markets in high tech, knowledge intensive products and services is only one special application of general internalisation theory, not the whole story. Markets continue to be internalised to secure supplies of key inputs and avoid the hold-up problem, to ensure quality control, to allocate internal resources including finance in the absence of perfect capital markets (particularly futures markets) to monitor perishable and otherwise degradable intermediate products and to avoid or reduce external interference – the use of internal transfer prices to reduce tax is a prime example. A key application of the theory should not be mistaken for the whole theory.

The key issue here is that we have three interacting processes:- internationalisation, innovation and organisational learning (Chiva, Ghauri and Algere 2014). The Uppsala approach examines the influence of organisational learning on internationalisation whilst internalisation theorists concentrate on the effect of innovation on internationalisation. Perhaps the interaction of all three processes is a way forward, but the precise causality is problematic.

This is further complicated by the empirical observance that innovations tend to be clustered in time (and often in space). Key leaps forward often occur because several innovations arrive by almost simultaneous discovery. Perhaps this is because the fundamental assumptions underlying seeming disparate inventions are in accord – leading to the observation that the sequence of innovation is important (and path dependency analysis). This can be captured by restructuring the basic analysis of internalisation around a network of sequenced innovations.

3.6. Risk and Uncertainty

In international business research generally and in internalisation theory in particular, uncertainty (especially that arising in the internalisation of the firm) is generally perceived as arising from lack of information and therefore knowledge collection, particularly knowledge arising from experience, is seen as the antidote to uncertainty (Liesch, Welch and Buckley 2011). As Buckley and Carter (2004 p 372) say "Our view of knowledge is that it is the converse of uncertainty … uncertainty inhibits the ability of firms to create value by limiting the scope and effectiveness of the activities they undertake". The rational action basis of managerial decision making that underlies internalisation theory is well suited to the application of real options theory (Kogut & Kulatilaka 2001, Buckley, Casson, & Gulamhussen, 2002) to internationalisation processes where 'options' on future internationalisation (or dinternationalisation) moves can be moderated by information gathering.

There are calls to go beyond such an approach. One such attempt is to examine, using sophisticated psychological methods, the decisions that managers make in internationalising, and the role that risk and uncertainty play in these decisions (Buckley, Devinney and Louviere 2007). The inclusion of radical, non-ergodic uncertainty that cannot be represented as a probability distribution ('Knightian' risk (Knight 1921)) requires real choices to be made where outcomes are not known and possibly not knowable. It is argued that this puts the individual manager or entrepreneur centre stage in the analysis but is also clouds the relationship between the decision and the outcome. At its extreme, it renders means-end relationships invalid. Bounded rationality only in part capture this dilemma. Like Knightian risk as a reduction of uncertainty so Williamsonian bounded rationality limits the potential decision set to those that fall within manager's comprehension – the rest is akin to an 'Act of God'. It may well be that, in the current state of knowledge, internalisation theory has incorporated as much as is possible of uncertainty (unknowable risk) into deterministic general models and that the rest of the work, for now, has to be done on case-by-case or qualitative investigation.

As Buckley and Strange (2011 p 465) point out, firms do not exhibit stable risk preferences. This is interrelated with governance issues because it is individual managers who make decisions about strategy and they are subject to change as are the risk preferences of the key stakeholders (and the stakeholders themselves) overtime. The risk propensity of individual MNEs thus is dynamic and responds to both internal and environmental change.

3.7. Entrepreneurship

The integration of entrepreneurship research with international business research and internalisation theory is not just an opportunity - it is a network of opportunities. As Casson (1995a) shows, this integration offers a synthesis of, not only IB and entrepreneurship, but of cultural issues in a business and economic perspective through the notion of 'entrepreneurial culture'.

Casson (1982) defines the entrepreneur as “someone who specialises in taking judgemental decisions about the coordination of scarce resources”. This means that the individual, not the firm or any other institution, is the basic unit of analysis. The firm itself emerges as the institutional product of the first stage of the specialisation process, taking over from workers the problem of how to organise themselves as a team and from wealth holders the problem of how to manage the resources that they own. The entrepreneur becomes a bearer of uncertainty (Knight 1921). The link with internalisation theory is that intermediation and internalisation are transactions cost reducing strategies as the entrepreneur improves trading relationships in the growth process. This results in a division of entrepreneurial labour between firms or specialised units.

A key problem in integrating work on entrepreneurship with IB has been the alleged problem of subjectivity. Casson (1995a Chapter 5, particularly pages 122-124) shows that heterogeneous expectations are compatible with a simple model of entrepreneurship and that subjectivity, widely discussed as an individualistic phenomenon, also has a collective component – a hugely important link with culture defined at the appropriate community level – be it nation, region, religion, city, clan, family, firm or business group. Such groups, drawing on shared values, norms and beliefs, “collective programming of the mind” (Hofstede, 1991) may not be aware of collective influences at individual level but this may show strongly in data.

The nexus of internalisation theory, models of the entrepreneur and the role of culture is a massively underexploited research resource, offering a way out from the mutual incongruence of theories of the firm and individualistic subjectivist views of entrepreneurship (Sarasvathy, 2001). The reconciliation of writing on entrepreneurship and international business would be a positive by-product of such a reconciliation.

3.8. Firms, Networks, Global System

Internalisation theory is versatile and we should not be surprised that it is capable of being the central concept in a number of theoretical frameworks. The unit of analysis may be the (multinational) firm (Buckley and Casson 1976), the supply chain, networked firm or ‘global factory’ (Buckley and Ghauri 2004, Buckley 2009) or the global system (Buckley and Hashai 2004, Casson 1995b, 2000). These approaches are rather like Russian dolls – fitting within one another with increasing generality of approach.

The firm based view examines the competitive advantages of the firm and the implications of this for strategy and structure. An excellent examplar of this is Dunnings ‘eclectic paradigm’ (Dunning and Lundan 2008). The boundaries of the firm, and the decision on outsourcing versus internalisation (critically important in the firm based theory as the choice of licensing versus FDI) remain central in the supply chain view, although more boundaries are seen as permeable. The division of entrepreneurial labour between MNE and its satellite firms becomes critical in this model (Rugman and D’Cruz 2000). The global systems view examines the firm and its environment and analyses how far linkages within the global system are coordinated within the MNE and how far they are market coordinated. The global system view highlights the strategic importance of interactions between flows of product (and services) and knowledge flows (Adler and Hashai 2007). The characteristics of technologies, products and locations that stimulate the emergence of MNEs and the flows of FDI are identified in the global system view (Casson 2013). This brings us back full circle to the MNE centred internalisation theory. From a systems view, international supply chains are the basic building blocks of the global production system. An individual supply chain for a particular product is a microcosm of the global system as a whole (Casson 2013). The global system view allows the strategies of "independent" firms to be shown as inter-dependent – because positions in the supply chain are to some extent determined by the strategies of other firms. This allows an analysis of dominance and negotiation. In contrast, the firm centred view typically takes the strategies of other firms as given – and suggests that the dominant firm will be the one with the greatest advantage. The systems view suggests that advantages are context – dependent.

This structure allows analysis to explore various viewpoints. These include the perspective of a manager of an individual firm deciding on strategic choices. If the constraints on these chances are correctly identified, then these can be aligned with restrictions on the theoretical possibilities of the firm-centred model. Alternatively, the global systems view is more appropriate for addressing long term global issues involving the interaction of the firm and its environment. This is a more detached and long term viewpoint. Thus both radical, long term change involving global adjustments where competition and cooperation create destroy and maintain firms can be analysed in the global system view whereas firm-centred approaches focus on incremental adjustments made by existing firms.

4. Conclusion

Problems with internalisation theory need to be problems with the frontiers of social science. If international business theory lags behind the best of social science theorising, then it is not succeeding (Buckley 2002, Buckley and Lessard 2005). Identifying lags behind this feasible frontier is the first task of international business research, pushing beyond it is the major goal.

There have been major steps forward in applying internalisation theory to the multinational enterprise. The basic internalisation theory of the MNE (Buckley and Casson 1976, Hennart 1982, Rugman 1981, Dunning 1979, 2000), the analysis of joint ventures and trust (Buckley and Casson 1988), the rigorous analysis of foreign market servicing strategies (Buckley and Casson 1996, 1998a, 1998b, 2011). The development of the global systems view has led to the conceptualisation of the 'global factory' incorporating entrepreneurship and network theory into the analysis and allowing the theory to fully encompass emerging market multinationals (Buckley, Clegg, Cross, Voss, Xin and Zheng 2007, Buckley and Hashai 2014). The nexus of entrepreneurship, innovation, culture and network theory represents an exciting and challenging research frontier.

Internalisation is a theory that actually works. Moreover, it is relevant for both managerial decision making and policy construction and appraisal because it can be expressed in clear, basic language. The managerial implications include – the design of optimal market servicing and input sourcing strategies, the choice of appropriate governance modes and of an optimal location strategy. Its policy implications arise out of the view that multinational enterprises have both positive (encouraging innovation) and negative (restricting competition) effects which depend precisely on context and environment. Intelligent policies can be devised and revised in accordance with the prediction of the theory and with careful specification of context.

Table 1: Internationalisation Theory: Context, Environments and Phenomena

	1976	The 1980s	The 1990s	The Early 2000s	2015
Context	Hostility to MNE	Indigenous Development Power to "host countries"	Strategies of MNE Entry and Development	How to attract FDI in Development Global Value Chains Rise of China (BRICs)	Plurality of Locations and Modes
Environments	Big Firms, Small Countries	Attention to (capitalistic development) LDCs "Competitiveness" Global Commodity Chains	Best use of foreign resources	Competition for FDI Governance BRICS	Worldwide Competition for activities
Phenomena	Unitary MNE 'Western Hegemony'	World Trade in Goods and services – transfer pricing/internal trade Small(er) Firm Foreign Investment Alternatives to the MNE. Country Competition JVs as "solution" Foreign Market servicing strategies	Flexible MNE	Externalisation and Offshoring New Locations "Globalisation" Emerging Market MNEs EMNEs and the basis of their Competitiveness	World Trade in Tasks (activities) Internalisation of knowledge, Externalisation of Activities Non-equity Modes (UNCTAD WIR 2012)
Internalisation Theory: Key Publications	Future of the Multinational Enterprise (Buckley &	The Entrepreneur (Casson1982) Vertical Integration/Intermediate Product Trade (Casson 1985, 1986)	Buckley and Casson Models of MNE (1998a)	Global Factory (Buckley and Ghauri 2004) Global Systems View	Market for Market Transactions (Liesch et al

	Casson 1976)	Rugman (1981) Inside the multinationals Casson (1979) Alternatives to the MNE Theory of Cooperation (Buckley and Casson 1988) Limits to Explanation (Buckley 1988) "Competitiveness" (Buckley, Pass and Prescott 1988) Porter (1990) The Competitive Advantage of Nations.	Knowledge Based Theories (Buckley and Carter 1999)	Buckley and Hashai (2004) Real options (Kogut & Kulatilaka 2001) COFDI explained (Buckley, Clegg, Cross, Voss, Xin and Zheng 2007) Buckley and Hashai (2014) Question the theoretical necessity for 'ownership advantages'	2012) Hennart (2009) JIBS 'Bundling' Buckley and Casson (2011) Marketing and the Multinational.

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