

# The multinational enterprise as an internal market system<sup>☆</sup>

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## Abstract

This paper builds on Birkinshaw's model of multinational enterprise (MNE) as an internal market system [Birkinshaw, J. (2000). *Entrepreneurship in the global firm*. London: Sage]. This model addresses the issues related to the emergence of market-based mechanisms of coordination within the MNEs and the strategic decisions that affect internal competition. Birkinshaw argues that subsidiaries simultaneously participate in three different internal markets within an MNE: a market for intermediate goods and services, one for charters and another for competencies and practices. The goal of the paper is to expand Birkinshaw's concept of internal market and analyze the logic behind internal competition by considering more fully existing literature and developing an organizing framework to position such a model within that literature. There is specific focus on discussing how the internal market model relates to modern network-based configurations of the MNE. In addition, the study shows that factors affecting the extent to which each of the three internal markets is established can be better understood if we link such a model to the contributions developed by three mainstreams of research: internalization theory, resource-based view and organizational learning literature. © 2006 Elsevier Ltd. All rights reserved.

*Keywords:* Internal markets; Hierarchy; Network; Subsidiaries

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## 1. Introduction

This paper analyzes Birkinshaw's (2000) model of multinational enterprise (MNE) as an internal market system. This model addresses the issues related to the emergence of

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market-based mechanisms of coordination within the MNEs as well as the strategic decisions that affect the working of internal markets.

By splitting the internal market into three (one market for intermediate goods and services, one for charters, and one for competencies and practices), Birkinshaw's framework can be a useful starting point for analyzing the logic behind the way internal competition works in a modern MNE. However, the theoretical foundations and implications of the model are not discussed in Birkinshaw's book. The author himself states that the framework of the MNE as an internal market system has not been widely developed. He recognizes that 'it is not yet clear if this approach will yield any valuable insights' (Birkinshaw, 2001, p. 388). Exploring this is within the scope of this paper, which is structured as follows.

Section 2 briefly describes the shift from a hierarchical to a network-based configuration, which characterizes recent theoretical perspectives of the MNE. In the 1990s, research, in particular, on network theory and resource-based view provided new insights for the analysis of strategies and configurations of modern MNEs. In spite of the differences in their contributions to the theory of the MNE, these more recent theoretical perspectives share a common emphasis on processes, decisions and patterns of capability development that take place at subsidiary level and on their influence over the MNE's strategic behaviour and competitive advantage.

Section 3 analyzes the context that the internal market model best fits. As the strategy and organization of MNE have changed considerably over the last 20 years, the explanatory power of the different models is to be evaluated in close connection with the conditions in which the MNE's activities take place. Through analysis of the essential features of market and hierarchy, this section focuses on what is meant by *internal market* and embodies the discussion of the model within the modern network-based view of the MNE.

Building on Birkinshaw's identification of three types of internal market within the MNE, Section 4 develops a set of propositions concerning factors affecting the extent to which each market is established. The thesis around which the framework is developed is that internalization theory, resource-based view and organizational learning literature provide useful contributions to the analysis of the MNE's internal markets. Section 5 summarizes advances and limitations of this study and shows some directions for future research in the field.

## **2. The modern MNE: from hierarchy to network**

Internalization theory (Buckley & Casson, 1976; Rugman, 1981) has been the most widely adopted theory for the explanation of the existence of the MNE. Such theory draws on transaction cost economics (Williamson, 1975), which focuses on the organization of economic activity in markets and firms. Transaction cost economics argues that price system (markets) and hierarchy (firm) are the two different ways of organizing any given transaction. Markets are less than perfectly efficient because of bounded rationality and opportunism. Market failures or high transaction costs, experienced through market transactions, make hierarchy a more efficient mechanism of organizing economic activities.

On the basis of these considerations, internalization theory explains the existence of the MNE as a response to imperfections in international markets. The MNE emerges as a way of coordinating activities across countries when ownership-specific and location-specific advantages combine with intermediate market imperfections (Dunning, 1981, 1988). The preference for market or hierarchy is based on the evaluation of the costs related to their governance mechanisms: the existence of the MNE will occur when the organization within the firm of interdependencies between agents located in different countries is more efficient than

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