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A transaction cost approach to a paradox in international marketing ☆

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Abstract

Why do firms that make specific downstream investments as they start international operations, sometimes turn to more market-like arrangements as they gain international experience and their international sales increase? This paradox in international marketing is the key question to be addressed in this article. We use the concept of dynamic or temporary governance costs to examine the paradox. The pattern of internationalization in the Norwegian farmed salmon industry provides an example whereby Norwegian exporters established their own sales offices in several international markets in the early stages of internationalization, but subsequently disintegrated vertically and came to rely on more market-like arrangements. An analysis of the internationalization of this industry suggests that, over time, the market provided better capabilities than vertical integration. This reduced the transaction costs, thus making vertical disintegration an efficient strategy.

Keywords: Internationalization; Disintegration; Dynamic governance costs

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1. Introduction

This article addresses an apparent paradox in international marketing. In some industries, firms making downstream specific investments when they start their international operations often turn to more market-like arrangements as their presence in international markets becomes stronger and their international sales increase. One example of this is the international farmed salmon industry, which will be addressed here. Such disinvestment appears paradoxical for at least two reasons. First, the standard wisdom offered by the international marketing literature is that firms make specific investments successively as they expand their international operations. The influential Uppsala internationalization model, for example, describes firms going through a series of stages ranging from no regular export activities, through export via independent representatives, on to the establishment of a foreign sales office, and finally to the establishment of foreign production units (e.g., Johanson & Vahlne, 1977; Johanson & Wiedersheim-Paul, 1975). The history of internationalization in a variety of industries also suggests that such successive involvement followed by increased specific investments seems to be a valid description. Even in the case of firms described as being "born global", some sort of stepwise—albeit rapid—internationalization, followed by rising levels of specific investment seems to be the pattern. We refer to Andersen (1993), Bjökman and Forsgren (1997), and Liesch et al. (2002) for recent overviews of Nordic contributions to internationalization research.

A basic assumption underlying the gradual internationalization model is that firms move away from the "known", i.e. the domestic market, and towards the "unknown", i.e. new markets which, due to their novelty and the firms' consequent lack of knowledge, are often regarded with a high degree of uncertainty. When perceived uncertainty is high, risk-averse firms are expected to abstain from making specific investments. The process model can be described as a "test-the-water" approach. Firms first undertake minor investments in order to learn. Then as they gradually learn to handle new markets and positive outcomes are achieved, perceived uncertainty declines. Firms thus become more confident and willing to make specific investments. This can be described as a kind of risk-reduction behavior. Firms will not make substantial specific downstream investments until they have learnt the new marketing environment and feel that they possess the necessary competencies.

Moving towards market-like arrangements seems to indicate that specific investments are being abandoned and represent sunk costs. If firms make specific investments in the initial stages of their international operations, but later discover that the expected sales and profits will never be realized, then such behavior is understandable. However, the focus here is on vertical disinvestment in growing markets. We study firms operating in the international farmed salmon industry, and many firms in this industry made specific investments in foreign sales offices as they embarked on international operations. Over time, however, most of these firms have moved on to more market-like arrangements, such as spot market transactions or long-term relationships with foreign importers.