International Business Review 18 (2009) 224–235

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

Internalisation thinking: From the multinational enterprise to the global factory

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A R T I C L E I N F O

Article history:
Received 12 December 2007
Received in revised form 9 January 2009
Accepted 19 January 2009

Keywords:
Externalisation
Global factory
Internalisation theory
Multinational enterprise
Outsourcing

A B S T R A C T

Internalisation thinking is traced from its inception by Coase through its application to multinational enterprises and to the global factory. The general principles governing the internalisation of markets are revisited and the focus on innovation, the dynamics of internalisation and its application to newer structures of firms such as the global factory are emphasised.

1. Introduction

In The Future of the Multinational Enterprise (Buckley & Casson, 1976) set up a research agenda that is still being worked out. The principles of internalising a market and least cost location of activities are part of a wider research agenda whose key elements are: (1) information costs (knowledge management); (2) systems theory (networks); (3) innovation (entrepreneurship) and (4) differences in social interaction across the world (psychic distance).

The intellectual journey traced here is the transition from the theory of the multinational enterprise to "the global factory". (Buckley, 2004a, 2007, 2009; Buckley & Ghauri, 2004).

2. Internalisation–externalisation

The key issue is that the underlying theory does not change but the actions of firms respond to changing circumstances. The balance between externalisation and internalisation has shifted but the principles underlying the decisions determining the boundaries of the firm have remained. These may be listed as advantages and disadvantages of internalisation (or conversely the costs and benefits of using the market). These shifts over time are traced below.

3. The advantages of internalising a market

The general advantages of internalising an imperfect or missing external market can be listed as follows:

1. Coordination of multistage process in which time lags exist but futures markets are lacking.
2. Discriminatory pricing in internal markets allows efficient exploitation of market power.

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0969-5931/$ – see front matter
doi:10.1016/j.ibusrev.2009.01.006

3. Bilateral concentration of market power – internalisation eliminates instability.
4. Inequalities of knowledge between buyer and seller (''Buyer uncertainty'') removed.
5. Internal transfer pricing reduces tax liability on international transactions (Buckley & Casson, 1976, pp. 37–39).

These factors drive the consolidation of firms and account for both large uni-national and multinational firms.

4. The costs of internalising a market

In every case the advantages of internalising a market must be compared to the costs.

1. Higher resource costs when a single external market becomes several internal markets (can be reduced by partial internalisation).
2. Communication costs in internal markets rise (vary with psychic distance).
3. Political problems of foreignness.
4. Management costs in running complex multiplant multicurrency operations (Buckley & Casson, 1976, pp. 41–44).

The costs of internalisation are often underemphasised, or even ignored leading to an unbalanced view of the theory. Where costs exceed benefits, markets will not be internalised and market solutions (external licensing, outsourcing) will be sought. The (changing) choices of foreign market entry and development are key features of the internalisation approach (Buckley & Casson, 1981, 1996, 1998a, 2001).

5. The future of the multinational enterprise: broad-based intellectual framework of Coase

The future of the multinational enterprise analysed the multinational enterprise within a broad-based intellectual framework based on the pioneering work of Coase (1937). It demonstrated how seemingly unrelated aspects of multinational operations, such as technology transfer and international trade in semi-processed products, can be understood using a single concept – the internalisation of imperfect markets. The idea of applying Coase to multinationals occurred to a number of other authors at about the same time. (Hennart, 1982; Hymer, 1968; McManus, 1972; Swedenborg, 1979). The distinguishing feature of this book was that it provided a particularly compact and parsimonious explanation of the evidence (Buckley & De Beule, 2005).

Parsimony was achieved by invoking the principle of rational action modelling, which not only lies at the heart of economics, but provides a basis for rigorous research in other social sciences too. Rational action modelling applies to a wide range of international business issues, including dynamic market entry (Buckley & Casson, 1981, 1998a, 1998b), international joint ventures (Buckley & Casson, 1996), international entrepreneurship (Casson, 2000), business culture (Buckley & Casson, 1991; Casson, 1991) and strategic complexity in international business (Buckley & Casson, 2001).

The general approach embodied in The future of the multinational enterprise sheds light on the internal mechanisms of the firm by opening up the 'black box' to analyse the relationships between production, marketing and R&D, whilst leaving a 'single rational mind' to configure the boundaries of the firm. Here, the role of information costs is crucial when examining the costs of monitoring employees (agency costs) and the costs of inefficiencies and mistakes (which may be worth bearing if the expenditure that would be incurred for correction is great). Organisations thus have an economic logic to their design (Buckley & Carter, 1996, 1997). When the rational action approach is taken, many of the precepts of system theory are found to apply in the appropriate context. For instance, rule-driven behaviour is shown to be rational in certain types of environment but in others entrepreneurial improvisation is correct. Economy of co-ordination calls for a division of labour in information processing and this in turn calls for co-operative behaviour of a social nature (Buckley & Casson, 1988). Because the environment of the firm differs in different (national) locations, there will be differences between locations in the kinds of decision making rules that are used. In other words, social interactions will follow different rules in different places. (''Psychic distance'')

6. The future of the multinational enterprise: not so much an ending as a beginning for a research agenda

The future of the multinational enterprise presented not a complete theory but the core of a general approach to MNEs and their near relations (Buckley, 2002; Buckley & Lessard, 2005). It is not the system of concepts and the particular insights that are crucial but an appropriate method of analysis. The theory can analyse alternative contractual arrangements ''externalisation theory of the firm'' and disintegration is raised as a possibility. Overall the future of the multinational enterprise is not unorthodox. It retains profit maximisation and marginal calculus as its key analytical elements. Imperfections are made explicitly (observable and systematic) so direction of growth is predictable. The methods used were to compile stylised facts in a testable fashion to derive predictions. An important innovation was the modelling of dynamics especially R&D and innovation. It was suggested that the dominant force for internalisation was undergoing change. ''The advantages of internalising specialised technical know-how are diminishing relative to the advantages of internalising general marketing expertise''. (Buckley & Casson, 1976, original preface (xxi))