Since market share. the theory of the firm

Economics, Currency

Since the end of WW2 the world has seen an increase in the amount of international trade of goods and services between nations (World Trade Report 2008).

This essay seeks to highlight the potential reasons for firms to engage in international business and why firms become multinational enterprises. The text will then proceed to explain in further detail the most important motives. Further the essay will also discuss how businesses internationalise using the Uppulsa model, Eclectic paradigm and Networking theory. Lastly a real world example of a firms internationalisation to support the given explanations will be presented.

International business is defined as " commercial transactions that occur across borders"(Guy, 2009) and a multinational enterprise is a firm that owns business operations in more than one country thus MNE's play a large role in International business (Hill and Hult, 2012). There are a multitude of reasons for firms to become and MNE. The main motives for a firm are to increase brand recognition, to spread risks due to differences and changes in world economies, to compete with rival firms, to survive as a an organisation, to increase profits by increasing market size, to have have a technological advantage, and to reduce production costs (Guy, 2009). Arguably the most important reasons for firms to engage in international business are to increase profits, reduce minimize risks and to increase market share.   The theory of the firm states that the main goal of any firm is to maximise profits thus it may be argued that the strongest motive for a firm to go international is to increase profits. As an example, 1 in 10 people buy a product or service for five dollars every month from a particular domestic firm in a country with 60 million people. That firm will make a revenue of 360 million dollars a year .

If that firm then decides to operate in another country with 300 million people where 1 in 20 people purchase the same product at the same equivalent price in their currency, combined the firm will make 1. 26 billion dollars a year in revenue. If we imagine that the cost of production in each country is roughly the same at 2 dollars per unit then the total profit will be far greater when operation in both countries rather than just one. Thus increasing profits is a main motive for firms to engage in international business. Suggested by Karagozoglu and Lindell in 1998, both opportunities within foreign markets and demand from foreign buyers were found to be the top two reasons for internationalization. These two factors support the above argument. Due to the increased competitiveness between firms in markets, firms may decide to expand into foreign markets in order to gain a larger percentage of market share (Hansen and Hedin, 2007) . By becoming international, firms will be able to reach more consumers and be the main product of choice in certain countries.

This helps them gain a greater percentage of market share and can take away market share from their main competitors. Lipton Ice tea for example focuses on maintaining a dominant market share in western europe to prevent competitors such as Nestea and Tao from expanding. If say ‘ firm a’ does not decide to sell its goods or services internationally and its main competitor, ‘ firm b’ does, firm b will see a large increase in total revenues which they then may use to increase advertising domestically or even reduce the domestic price of their goods or services to undercut firm a and potentially put them of business.

In the world today, markets are rapidly changing with new trends constantly appearing and consumer tastes changing from country to country. “ Political, environmental, societal and economic risks exist within any market”. If a firm is trades in one sole market and the potential risks will have a devastating effect on a company if they were to occur “ Unless businesses build resilience and prepare for large-scale shock events, effective risk prevention and mitigation will be impossible” (Goldin, 2010). By engaging in international business, if the economy is slow and/or demand is falling in one country, the effect on the firm may not be felt as sales in another country may be increasing. For example, apple sold 15 million iphones in Japan in 2015 and 71 million phones in China that same year (Business insider). If apple were to see a fall in sales in the japanese market, their Asial market share would still be high if they were able to maintain their sales in China. Numerous different views exist on how the concept of internationalisation should be defined. Some see internationalization as, “ a process in which specific attitudes or orientations are combined with successive stages in the evolution of international operations” (Cherunilam, 2014).

Others have described internationalisation as, “ a sequential and orderly process of increased international involvement and the associated changes in organizational forms” (Bilkey/Tesar 1977). Most commonly in the study of businesses however we say that internationalisation is the “ growing tendency of organisations to operate across national boundaries.” There are a wide range of entry modes, approaches, theories, paradigms and models on how firms internationalise. This section of the essay will discuss the ' Uppulsa mode'l, created by Johanson and Valhne in 1972, which is a process view on internationalisation. The ' Eclectic paradigm' developed by Dunning in 1979 which entails how firms internationalise through the advantages which they posses and the Network approach developed by Elo and Fletcher in 2008 which highlight how firms internationalise through the forming of trust and relationships. The process of each approach will be discussed as well as key figures in their development. Limitations of theory will also be presented.

The Uppulsa model, based on empirical observations from Sweden's University of Uppulsa, views internationalization as an " incremental process of acquisition, integration and use of knowledge on foreign markets" (Peter J Buckley and Pervez N Ghauri). Suggested by the model, firms start by exporting to a country via an agent or distributor, then move to establish a sales subsidiary and eventually begin production in the host country but not in all cases. Although renowned the Uppulsa model has its limitations. was revised by its authors in 2009 (Kubí? ková, 2014). Shown below is an illustrative model of the Uppsala model.(Digit Pro, 2018)The Eclectic paradigm or Ownership Internalisation Localisation theory (OIL) considers that a firm has three potential advantages, ownership advantages, location advantages and internal advantages (Otto Andersen). In terms of ownership then it should chose licensing agreements as a means of transfer to internationalise.

If a firm possesses ownership and internalization advantages then in may internationalise through producing domestically and then exporting their products. Lastly if a firm possesses all three advantages then it should internationalise through foreign direct investment (Hill and Hult, 2012). In order to for a firm to internationalise, from the network perspective, it must understand its market, the environmental conditions and its own relationships within that market. By building trust and increasing the number and strength of relationships with networks in foreign countries, the firm will gain penetration. Following the penetration of a network, international integration is achieved through working with firms in other countries. If a strong relationship can be formed with the foreign firms, access to the market and it resources are then gained (Hosseini and Dadfar, 2012). Other theories on how firms internationalise exist, the three mentioned above however provide a broad spectrum in terms of when the theories were formed and the types of methods which each theory employs.

The internationalisation of Louis Vuitton Moet-Hennesy (LVMH) can be viewed using the Uppulsa model. The multinational conglomerate bought brands such as Kenzo, Dkny and Marc Jacobs in order to be culturally closer to geographically far countries. In stages, LVMH assess the foreign markets then Export to new selected countries.

Networking within foreign markets in order to find vendors of their product begins. LVMH is a luxury brand thus production in foreign market is rejected (4th stage of uppsala model). In conclusion, as discussed in the main body of this text, firms to become Multinational Enterprises mainly to maximise profits, increase their market share and reduce risks. It may be argued that in today’s world firms may internationalise to gain market share over increasing their profits and may even be willing to make a loss to gain a larger proportion of market share from their competitors. In terms of the process of internationalisation this paper concludes that the original Uppulsa model is the most outdated and that the networking perspective is the most relevant in today’s world.

Attention has been focused on the new perspective of networking theory when it comes to the justification of internationalisation.