

# Uppsala model, transaction cost theory and network model



**ASSIGN  
BUSTER**

According to Calof and Beamish (1995), internationalization is “ the method of adapting organizations’ operations (resources, strategy, structure,) to foreign environments”. This process comprises of the amount and geographic distance of the foreign market that is entered; the different amount of activities that are carried out in the different countries and the intensity of integration of these activities. Firms go into internationalization as a result of their customers migrating and their competitors globalizing while some companies go into it as a symbol of success and progress (multinationalism idea).

Due to the complexity of the processes involved in the internationalization, several theories have been designed by different scholars to enable the easy accomplishment of the international emerging markets. Amongst the theories and their different features that are to be discussed are; the Uppsala Model, Transaction Cost theory and the Network Model.

Uppsala Model of Internationalization is the theory that is based on the learning and the evolutionary viewpoint. This theory is derived from the behavioral theory which is explained as the nature of the firm through behavioral actions of its customers and the country of its emergence (Cyert and March, 1992). This theory’s strength is based on the knowledge on how to conduct a business in a foreign market on which without the knowledge, the intended company to internationalize would be rendered handicapped (Carlson, 1966).

Firms using this theory have the tendency of entering a new market successfully through the geographic and psychic distance which means “ the

summation of factors that is hindering the flowing of information from one market to another market; these include differences in language, education, business practices, culture, and industrial development” (Johanson & Vahlne, 1977, Johanson & Associates, 1994). Just as it was mentioned in the 3rd lecture on the 8th of February, the socio-cultural environment/ culture and cultural differences have a big role to play when a company is entering a foreign market, this is because the ways of life of the people, organizations and government will be different from that of the domestic country of the entering firm. This means that the company has to plan on different strategies to use like using two or three languages pattern as the organizational language base and strategies to suit the country’s religion and other sensitive factors in order to be able to penetrate faster than it would have taken.

“ Thus, the model expects that the internationalization process, once it has started, will tend to proceed regardless of whether strategic decisions in that direction are made or not.” (Johanson & Vahlne, 1990,)

There are two types of knowledge that are involved in this theory; the general or objective knowledge which can be taught and the market-specific or the experimental knowledge which can only be learnt via personal experience and is difficult to transfer nor separated from its original source (tacit knowledge) Penrose, (1959). The experimental knowledge is very important as it cannot be easily acquired like the objective knowledge.

An example of this can be the carrying out of marketing researches and reports. All the information on the threats and opportunities of the

international market can best be gotten from the people working in that country just as it is explained in Johanson and Vahlne, 1990; That it is the experience that generates the business opportunities and constitute the driving force in the internationalization process. This is why this theory is seen to be a slow process because it involves the learning through experience from a firm's own activities. It is always the lack of experiential knowledge in the new market that pushes the firm to use the internationalization characterized gradual process which is in stages and known to the " Establishment Chain" (Johanson and Wiedersheim-Paul, 1975).

### **Critiques of Uppsala Model**

This model is too deterministic because its principles are predicted by the evolution of time. All its advances are based and controlled by the environment of which the firm exist or planning to internalize. The model does not take into account the interdependencies between different countries's markets of which a firm operates under.

This model is mostly relevant to the physical product industries but usually very slow in entering distant markets in terms of ' psychic distance' at an early stage and its frequently not valid for the service industries as services can be dynamic and more time compressed also requires initial commitments. Subsequently, there are many models and strategies that facilitate the faster and easier avenues to extend a business abroad, therefore, it is no longer necessary to build up knowledge using the ' in house' method due to the present technology nature that stimulates the interactivity with customers.

<https://assignbuster.com/uppsala-model-transaction-cost-theory-and-network-model/>

To conclude this theory, it is quite clear that this theory has the competitive advantage opportunities base to the amount of resources and researches that are carried out in the foreign country before entering.

This model only focuses on the selected firm unlike other models that extends their researches to environmental explanatory variables rather than being static.

**The key features of Uppsala theory are:**

- Firms first of all achieve their knowledge from the home market before moving to the distant markets.
- Organizations start their overseas' operations from culturally/geographically and religiously close nations and progress slowly to culturally and geographically further far-away countries.
- Organizations also launch their overseas operations by making use of the traditional exports and slowly but surely moving to the using of a more intensified and demanding operational modes like sales subsidiaries at the company and target country level.
- It is the objectives of the firm to produce abroad I all markets.

Transaction Cost Theory is a cost that is incurred in creating an economic trading (which is the cost of taking part in a market, economies of scale and transportation cost). This involves all the cost incurred from the starting of a particular transaction to the end. This is the summation of all the expenses involved in establishing a new market in a foreign country, this include both the explicit cost and the implicit cost and it affects both the both the service provider and the customer. Normally, it is advantageous to have the external

transaction costs more than the internal transaction costs, this will guarantee the company's growth but, if the internal transaction costs are more than the external transaction costs this will lead the company to a downscale by outsourcing.

Transaction cost economics arises when multinational companies are more efficient than their markets and contracts in organizing interdependencies between their agents that are located in different countries. It is the theory of the role and size of a firm.

If a company plans to utilize a firm-specific asset in a foreign market and this utilization has to be done in that market due to their localization factors for example, trade barriers, high transportation costs and some other specific factors, the company can best do this by obtaining the required license to invest abroad on their own facilities rather than using that of the foreign country's market. This is because; the more intangible the firm-specific assets are, the stronger its tendency of being successful would be.

Transaction Cost theory is closely related to the internalization theory. With the transaction cost theory, firms always strive to minimize their cost at all point during their operations and decision making. This is why firms would need to consider to either entering a foreign market with their total assets or collaborating with their external partners as externalization (Williamson, 1975). The failure of a foreign emerging market strongly depends on this decision (Williamson, 1979).

**The key features of the Transaction Cost Theory are:**

- \* The transaction cost approach focuses on costs and how these costs would affect a firm's choice of market and their modes of entry into a new boundary market.
- \* This theory views organizational structure as a single important arrangement for establishing and safeguarding transactions and reducing transaction costs between participants and across organizational boundaries.
- \* The Transaction cost covers all the costs of searching for information about a foreign market, products, buyers and sellers; negotiation costs; and monitoring which is part of the enforcement costs.
- \* Transaction costs and transactional difficulties increases when transactions are characterized by: Asset specificity; Uncertainty (internal and external); and Frequency of transaction.
- \* The international market decision is made in a rational manner base on the analysis of the cost of transaction.
- \* Organizations make decisions based on the evaluations and comparing of their cost of an entry mode that is related to their objectives.

**Critiques of Transaction Cost theory**

This theory can be wrong and also dangerous for corporate managers because of its assumptions on which it is based on. Firms are not mere alternatives for the structuring of efficient transactions when markets results disappoints; they hold a strong advantages for leading and controlling certain kinds of economic actions via a strategy that is extremely unusual

<https://assignbuster.com/uppsala-model-transaction-cost-theory-and-network-model/>

from that of a market both national and international. Transaction Cost theory is “ bad for being put into practice” because it fails to recognize the just mentioned difference (Masten, 1993).

Conclusively, Firms should select the organizational forms and locations for which transaction costs are minimized. (Donaldson & O`Toole, 2007). A firm should expand its operations until their cost of making an extra transaction within the firm is equal to the cost of making similar or more transaction in another place (foreign market). The firm should first of all continue to grow internally until external sources have a cost advantage before externalizing (Hollensen, 2007).

Network Model: In the network model theory, the market is seen as a system of social and industrial relationships among customers, suppliers, competitors, families and friends within a given boundary and beyond. This is for the purpose of creating the opportunity and motivation for internationalization. Following the network perspectives, the strategic decisions that are usually taken by organizations strongly depends on the relationships between the various parties and individual firms also depends on the resources that are controlled by other national and international firms.

**The structure of the Network Model can be demonstrated below:**

Actors

Activities Resources

(Johanson and Mattsson, 1988)

<https://assignbuster.com/uppsala-model-transaction-cost-theory-and-network-model/>



The key features of the Network Model are as follows:

- \* This model is based on the theories of social exchange and focuses on firm behavior in the context of inter-organizational and interpersonal relationships.
- \* The 'glue' that bonds the relationships together between the actors is based on technical, economic, legal and above all personal ties.
- \* The long-term relationships between business actors and the background in which the organization operates have the illustrative significance in the description of the internationalization of firms.
- \* A firm does not act alone in relation to other actors in a market.
- \* A conjecture in this model is that an organization is reliant on other firms' resources surrounded by the same network; an example is the customer and supplier relationships.

### **Critiques of the Network Model**

The start-up problem in this model prevents even-adoption of superior products; excess sluggishness can occur as no actor is willing to put up with the over proportional threat of being the first adopter of a standard.

In many cases, the existence of network effects could lead to a weak and inferior result in markets (pareto-inferior).

Also, In the case of sponsored technologies, there is a possibility to internalize the otherwise more or less lost of network gains by strategic inter-temporal pricing. Private incentives to providing networks that can

<https://assignbuster.com/uppsala-model-transaction-cost-theory-and-network-model/>

overcome the inertia problems can be made possible but still the assurance of social optimality would not be certain.

Conclusively, the network relationships are significant opportunities for the acquirement of resources and knowledge that are necessary for foreign development of firms. Also, the relationships of firms in a domestic network can be used as bridges to other networks in other Countries. Such direct and indirect bridges to different country networks can be important in the opening steps abroad and in the successive entry of new markets in an emerging industry.

## **References**

### **Books**

Cyert, R. M., and March, J. G., (1963). *A Behavioral Theory of the Firm*. Englewood Cliffs: Prentice-Hall.

Donaldson, B., and O'Toole, T., (2007). *Strategic Market Relationships: From strategy to Implementation*. Chichester: John Wiley & Sons.

Hadjiikhani, A., and Johanson, M., (2001). *Expectation- The Missing Link in the Internationalization Process Model*. New Plymouth: Pergamon Press.

Hollensen, S. (2001). *Global Marketing- A market-responsive approach*. 2nd ed. Gosport: Prentice Hall.

Hakansson, H., and Johanson, J., (1992). *A Model of Industrial Networks*. Stockholm: Almquist & Wiksell International.

<https://assignbuster.com/uppsala-model-transaction-cost-theory-and-network-model/>

Hollensen, S. (2007). *Global Marketing – A Market-Responsive Approach*, London: Prentice Hall.

Johanson, J. & associates, (1994). *Internationalization, Relationships and Networks*. Stockholm: Almqvist & Wiksell International.

Johanson, J., and Vahlne, J-E., (1977). *The Internationalization Process of the Firm- A Model of Knowledge Development and Increasing Foreign Market Commitments*. Stockholm: Almqvist & Wiksell International.

Johanson, J., and Vahlne, J-E. (1990). *The Mechanism of Internationalization*. Stockholm: Almqvist & Wiksell International.

Johanson, J., and Mattson, L-G., (1988). *Internationalization in Industrial Systems – A network Approach in Strategies in Global Competition* (ed. By Hood, N – Vahlne J-E. 287-314). Oxford: Oxford University Press.

Penrose, E., (1995). *The Theory of the Growth of the Firm* (3rd ed.). Great Britain: Oxford University Press.

Williams, O., (1985). *The Economic Institutions of Capitalism*, New York: The Free Press

## **JOURNALS**

Kotabe, M., and Helson, K., (2008). *Global Marketing Management*. *A Journal of Global Marketing*. 6th February, pp. 329-331.

Whitelock, J., (2002). *Theories of Internationalization and Their Impact on Market Entry*. *A Journal of International Marketing Review*. 7th February, 342-344.

<https://assignbuster.com/uppsala-model-transaction-cost-theory-and-network-model/>

Williams, O., (1979). Transaction Cost Economics: The Governance of Contractual Relations, *Journal of Law and Economics*. 3rd February, pp. 233-262.