

DOES THE UPPSALA INTERNATIONALIZATION MODEL EXPLAIN THE INTERNATIONALIZATION PROCESS OF PROFESSIONAL BUSINESS SERVICE FIRMS?

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The aim of this contribution is to verify if the Uppsala Model with later variations introduced by the authors is the right framework to explain internationalization process of Professional Business Service Firms (PBSFs). The focus is placed on the entry of one type of PBSFs, namely advertising agencies into the Chinese market. The example is based on a case study. This paper deliberates about identified factors in the internationalization process of advertising agencies that fit to the Uppsala model and about factors that deviate from it. Several stages are identified in the entrance of advertising agencies into the Chinese market. These are as follows: initial stage - external agent, participation stage - representative office, establishment stage - joint venture, network expansion stage – branch offices and other joint ventures. The presence of stages suggests that the Uppsala model may prove useful in explanation of foreign entry strategies in PBSFs in general. In addition to that, support is also found for market entry due to networking activities. Client following was identified as most common entry mode in the studied group of PBSFs.

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Introduction

The nature of Professional Business Service Firms suggests that their internationalization process might be different from that of manufacturing firms. It seems therefore that the applicability of Uppsala model to the internationalization process of Professional Business Service Firms is seen rather controversial by different researchers. This is the main reason, why we think, that it is important to inquire “if Professional Business Service Firms follow the Uppsala model of internationalization during their international market entry process”.

In the following sections we first introduce the original Uppsala Internationalization Model by Johanson and Vahlne (1977) and secondly present the latest advancements within the Uppsala School. Thirdly, we will then analyze the original internationalization processes of advertising agencies entering the Chinese market, based on a case study conducted by Cheung and Leung (2007). Fourthly, we will discuss if the empirical data is fitting to the explanations in the original Uppsala model and then again those in the advanced Uppsala model. Fifthly, we will draw conclusions from our discussion and our own findings and ask for further research in this field.

Key characteristics of Professional Business Service Firms

Professional Business Service Firms (PBSFs) are organizations such as business consultancies, legal practices, engineering firms and advertising agencies. Despite differences between professional

service industries – ranging from auditing to advertising – they all specialize in the creation, validation, and application of knowledge in order to solve client problems (Reihlen & Apel, 2007). Professionals are “counselors”, “advisors” or “experts” who can exercise a degree of control over their clients on the basis of complex knowledge. In contrast to the practical knowledge of semi-skilled labor, professionals depend largely on a stock of academic knowledge usually blended with creativity, discretion and pragmatically justified rules of thumb of the experienced practitioner (Abbott, 1988).

While these firms differ in their knowledge and capital intensity (von Nordenflycht, 2010), what differentiates them most strongly from other forms of organization is a focus on delivering services ‘within the constraints of professional norms of conduct’ (Fosstenlökken et al., 2003). By definition, PBSFs are organizations where expert knowledge workers (the ‘operating core’) exercise to a greater or lesser extent control over both the means and ends of services delivery.

The Uppsala School Model of internationalization

The Uppsala Model was conceptualized by Swedish scholars and it dates back to 1977. It has grown out of empirical research about Swedish firms competing internationally. The theoretical base of the U-model can be found in the behavioral theory of the firm (Cyert & March, 1963; Aharoni, 1966) and theory of the growth of the firm (Penrose, 1959). In the model internationalization is seen as a process in which the enterprise gradually increases its international involvement. As shown on the Figure 1, the process evolves as interplay between the development of knowledge about foreign markets and operations on one hand and an increasing commitment to resources on the other hand (Johanson & Vahlne, 1990). There are two types of knowledge that are to be distinguished: objective knowledge, which can be thought and experiential knowledge that can be only acquired through personal experience (Penrose, 1959). It is also referred to as market knowledge which is gradually developed during the internationalization process of a company and rising the more various international markets are entered (Ericsson et al., 2000). While more of this type of knowledge is acquired during internationalization of the company uncertainties associated with the commitments to a foreign market decrease. The experiential knowledge, however, is to a very large extent country specific, often difficult applied in other countries while increasing commitments to addressed markets (Johanson & Vahlne, 2003).

There are two patterns in the internationalization of a firm that the U-model can provide an explanation for. One is that a company’s engagement in a specific country proceeds along with the establishment chain that is composed of the following stages:

1. no regular export activities,
2. export via independent representatives (agent),
3. sales subsidiary,
4. production/manufacturing.

The sequence of stages not only represents increasing commitment of resources to the market, but also indicates current business activities that change alongside the experience gained. The first stage, gives practically no market experience. In the second one the firm has an information channel to the market and receives rather superficial information concerning the market conditions, but on regular bases. As the business activities undertaken in the two following stages are performed in the market the company gains a more differentiated and wide market experience that can even include factor markets (Johanson & Vahlne, 1977).

The second pattern explained by stage model is that companies enter new markets with successively greater psychic distance. The concept of psychic distance is defined as factors preventing or disturbing the flows of information between firm and market. Examples of such factors are differences in language, culture, political systems, level of education, level of industrial development, etc. (Johanson & Wiedersheim-Paul, 1975). Psychic distance is naturally correlated with geographical distance; nevertheless, exceptions to that rule exist. Some countries lay on two different sides of the globe like for instance United Kingdom and Australia, but for different reasons are close to each other in terms of psychic distance. Japan and North Korea are located near to each other geographically, however, due to political reasons, far apart as for psychic distance. Those examples show that psychic distance is not constant. It is subject to change following the development of the communication system, trade and other kinds of social exchange. Most of the changes will take place rather slowly; nonetheless changes due to political decisions may be very rapid.

New Developments of the Uppsala Model

Network theories do not, necessarily, negate the notion of psychic distance or challenge existing views concerning the incremental nature of internationalization. However, they do suggest that the whole process is much more complex and less structured than earlier theories and models imply.

Johanson and Vahlne (1990) themselves and Johanson and Mattsson (1988) come up with two important advancements of the Uppsala school of internationalization. Both basically keep the original theoretical settings of the U-model and by this are subject to the same limitations already discussed. Still these two advancements are seen as the most important contributions to the Uppsala-model as they deal with modern phenomena within the internationalization process of firms.

Firstly, Johanson and Vahlne (1990) state that the original assumptions of the company environment are implicitly consistent with today's understanding of firms acting in local and global networks. According to this understanding it seems quite easy to expand the original model by modern networking approaches explaining relationships between acting companies. The authors form a "network model of the internationalization of the firm" and state: "In the resulting model we can see firms learning in relationships, which enables them to enter new country markets in which they can develop new relationships which give them a platform for entering other country markets". Going along with this new extension of the model, the original assumption that internationalization is understood as a "learning by doing" approach, in which incremental learning is solely possible within the company, is inconsistent with the new understanding that knowledge can also be gained and transferred from other companies within the network or from acquisitions. This new view changes the original basic mechanism of internationalization shown in to this new network mechanism of internationalization.

Johanson and Vahlne (1990) state that existing network-relationships do become bridges influencing market selection and market entry strategy during the internationalization process. Due to this finding, internationalization has to be seen more as a result of existing and developing business-relationships rather than a concept of psychic distance. Secondly, thoughts by Johanson and Mattsson (1988) add a differentiation of four situations in an internationalization process to the thoughts about international networks. These are presented below in Figure 1.

Johanson and Mattsson (1988) broaden the internationalization model by differentiating between various situations, that are relative to the extent of internationalization of the very company and the market that is about to be entered. Furthermore, such issues as timing and speed of internationalization

steps and causes for internationalization, the size of companies or their experience in internationalization processes are addressed. Also the extension of the original “establishment chain” by mergers, acquisitions and joint ventures and nevertheless the allowance of skipping steps in the incremental internationalization model are taken into consideration and by this top the Uppsala-model off.

Both extensions of the Uppsala school of Internationalization do deal with and partly solve the problems associated with the assumptions and implications of the original model that are the most criticized and furthermore update the model to be still applicable in the 21st century. The rigorousness of the assumptions of the “psychic distance” and the “incremental establishment chain” are eased off by these extensions but stay valid.

Figure 1: Situations in Internationalization Process

		Degree of internationalization of the market	
		Low	High
Degree of internationalization of the firm	Low	The early starter	The late starter
	High	The lonely international	The international among others

Source: Johanson, Mattsson (1988)

Internationalization of Advertising Agencies

In this part we look at the internationalization of a type of Professional Business Service Firms, namely advertising agencies. We focus on the entry of these agencies to the Chinese market. The data-pool consisted of 32 joint venture advertising agencies including the world’s top 10 agencies and seven of the top 10 foreign agencies in China in 2003. Our empirical part relies on a study conducted by Cheung and Leung (2007). Based on the study conducted by Cheung and Leung advertising agencies used different initial entry modes and went through 4 internationalization stages. 12 of the agencies studied started initially operating in the Chinese market through the establishment of associate relationships with local organizations. 10 agencies were assisted in their entry by external brokers or media brokers. Three of the agencies had used both associate relationships and external brokers when entering the market initially. One of the agencies used a media broker’s assistance for the entry. Six agencies entered the Chinese market by using entry modes that require greater investments, as four of them engaged in a joint venture and two established a representative office. Majority of the advertising agencies (30/32) experienced changes in their initial form of operation due to their increased commitment by time. Most of the agencies started with associate relationships and external brokers, which was followed by opening a representative office, after which they engaged in a joint venture and in the last stage they opened a branch office or engaged in a second joint venture. In the initial stage (20/32) agencies operated through external brokers or associates. Hence, they set up headquarters, which tasks were planning and coordination of the agencies’ initial China activities like media placements. However, the associates carried out these activities. The agencies also needed to

work with other local partners such as local television stations, privately owned agencies, local media brokers or state-owned advertising agencies. These associate agreements were merely co-operative arrangements and did not involve equity. They also saved the companies from stationing their own personnel in China and allowed them to keep operating and set-up costs low.

In the second stage, participation stage, the advertising agencies (14) set up a representative office with reliance on an associate or broker. The representative office was used by the agencies as a contact point, which took care of liaising, establishing contacts with local media and advertising associations and collecting and reporting of media and market information to the head office. These representative offices were mainly located in Beijing, Shanghai and Guangzhou due to the agencies' client base, the concentration of media and expertise being located there. However, the headquarters of China operations was in charge of carrying out the advertising planning. The change from the external agent to establishing a representative office stemmed mainly from the fact that the agent served several foreign customers and thus did not have enough resources to properly serve each customer, which resulted in lower quality. The other main reason for the change was that client involvement in China increased.

In the third stage, the establishment stage, the advertising agencies, changed their structure to a joint venture. This change was made possible due to the changes made to regulations by the Chinese government as they introduced a preferential treatment policy. The main motivation for establishing a joint venture in China was the possibility to establish a local legal entity, which allowed them the legal right to trade, to solicit business, to issue invoices and to make media placements etc. Another main motivator for the change was increased requests and pressure from existing clients, as their scope of operations and business volume increased. The agencies realized that physical presence was required in order to provide quick face-to-face service to clients as well as to increase their clients' confidence. Some agencies advanced quicker in their internationalization and skipped the representative office stage. Majority of these agencies were based in Hong Kong. The reasons behind this movement from broker/associate stage directly to joint venture were resource commitment rationale, short psychic distance between Hong Kong and China and the benefits of a legal entity. For example in the case of Grey China Advertising they could rely on their broker to fulfill their clients' need and thus no representative office was needed. Later as their important key accounts such as Procter & Gamble and British American Tobacco entered the Chinese market, they felt they needed to make increased commitments in the form of joint venture to serve their clients better. Furthermore, the study also discovered that earlier entrants went through the different stages of internationalization, but later entrants started directly with joint ventures.

In the last stage, network expansion stage, the advertising agencies started to build networks and expand regionally by establishing branch offices and second joint ventures. Changes in regulations by the Chinese government in 1992 allowed the agencies to open branch offices in China. The reasons behind the expansion by setting up more branch offices were better possibilities to respond to the expansion of their existing clients and to attract new clients. On the other hand, requirement to adapt to local needs, clients' exclusivity requirement, company philosophy and regional differences in regulations served as reasons for setting up a second joint venture. This practice was used by all Japanese agencies, as it supported their company philosophy and was considered as a normal practice. Further reason for the establishment of a joint venture is the difficulty of obtaining a national license, which enables the establishment of branch offices. Furthermore, other characteristics of the network expansion stage are changes in organization structure and operations in the Asia-Pacific region due to clients' increasing needs. In practice these changes meant establishing one office to serve the greater China region. This meant that operations from the Asia-Pacific region were combined and carried out

in the regional office and headquarters were moved to China. This change embraced localization, as also the foreign expatriates were replaced by Chinese management and more employees and other resources were transferred to Chinese offices.

Discussion

When thinking about the original Uppsala model and the internationalization of advertising agencies, we can identify factors that comply with it, but we also recognize how they partly deviate from it. In the internationalization of the advertising agencies we could see that their involvement in the Chinese market increased in the course of time, stepwise, similar assumptions that are made in the Uppsala model. Majority of the agencies were early entrants in China and thus gradually increased their commitments in the market. Saatchi and Saatchi followed this pattern by first working together with a media broker and then setting up a representative office in Guangzhou. Two years later it engaged in a joint venture, which was followed later on by opening its own branch offices. However, the late entrants followed a different route that deviates from the internationalization pattern of Saatchi and Saatchi, an earlier entrant. The other eight firms followed an accelerated internationalization process and entered new markets by opening up a joint venture. This pattern is also recognized in the Uppsala model, as Johanson and Vahlne (1977) indicate that companies that already have knowledge and experience might not follow the stage pattern. In the case of the advertising agencies the late entrants have gained this knowledge by learning from the early entrants. However, it also needs to be recognized that in the case of the late entrants the regulations in China were more favorable towards a joint venture. The internationalization of the advertising agencies deviates from the original Uppsala model in terms of the reason for increased commitment in the course of internationalization. According to Johanson and Vahlne (1977) as companies gradually gain more market and experiential knowledge, they start to increase their commitments in international markets through the stage wise process.

However, demand and pressure from existing clients was the main reason for the advertising agencies to increase their commitments in China and not market seeking as the Uppsala-model supposes. For example, companies followed their clients to China without any initial market knowledge and only made greater commitments when their clients had expanded and thus required that from them. The advertising agencies' search for knowledge was neither driven by the internationalization, but rather by a desire to serve their clients better. The empirical sample for our paper is a perfect illustration of how important the extensions of the original Uppsala-model by Johanson and Mattsson, and Johanson and Vahlne are for today's understanding of internationalization.

According to our research question there seems to be a problem with the application of the Uppsala School of internationalization on the internationalization of Professional Business Service Firms. The main reason for this problem may be that the empirical data-set of the original Uppsala-model was pretty focused on industrial enterprises and by this fact a general validation of the model for Professional Business Service Firms cannot be easily assumed. In the original U-model it was stated that it may not be applicable for certain industries. There are companies in our empirical data-set that acted pretty much according to the behavior forecasted in the original Uppsala-model. Those agencies were the first ones to enter the Chinese market and by this they have to be seen as "The Early Starters" according to Figure 1. "Early Starters" typically don't have much knowledge about the market they expand to, and they also can't learn too much from their business network, although this network (especially their customers) might be the original reason for their step to internationalization.

Due to this situation “Early Starters” are following more or less the “incremental internationalization pattern” of the Uppsala-model until they become “Lonely Internationals”.

Then again not every company in our case was following the incremental steps of the “establishment chain” and by this they were acting against the original Uppsala-model. Johanson and Wiedersheim-Paul (1975) already stated that not every step on the “establishment chain” has to be taken, although they were more thinking about the last two, resource-intensive steps. The further development of the Uppsala internationalization theory by Johanson and Mattsson (1988) then again generally allows skipping steps also in the beginning of the “establishment chain”. Advertising Agencies from the article which did so are “Late Starters” and “Internationals Among Others” as they entered into the Chinese market later than the “Early Starters”. “Late Starters” and “Internationals Among Others” typically skip the first steps of the “incremental internationalization pattern” as they have to strive for a quicker way of internationalization and for gaining market shares and market knowledge quicker as “Early Starters”. Due to this fact, they might start internationalizing by Joint Ventures or Acquisitions to bridge the gap to the “Early Starters”. For those kinds of companies it is not unlikely that they do not enter a certain market for the reasons of market seeking, but also because partners or customers expect them to. Furthermore, some of these advertising agencies could skip some steps as they had a smaller “psychic distance” to the Chinese market, as they were originally located in Hong Kong.

Conclusion

We can hypothesize that due to the introduction of the network approach to the Uppsala school of Internationalization by Johanson and Vahlne (1990) and the acknowledgment and allowance of different reasons for and situations in internationalization processes by Johanson and Mattsson (1988) the expanded version of Uppsala model of internationalization is also able to explain the internationalization of Professional Business Service Firms in general and, after testing on our example data-set, the internationalization of advertising agencies in particular. To support this thesis fully, however, further research is needed.

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