Chapter 2

Rethinking internationalization process theory—An introduction to familiarity perceptions

2.1 Introduction

Internationalization process theory offers a behavioural model of international firm behaviour. This implies that instead of assuming that internationalizing firms have a perfect understanding of foreign contexts and operations, internationalization process theory depicts the firm as a learning entity which deals with a lack of knowledge and with high uncertainty through incremental decision-making. As such, the internationalization process model links “the development of knowledge about foreign markets and operations” to the “increasing commitment of resources to foreign markets” (Johanson and Vahlne, 1990: 11).

The assumptions of the internationalization process model, which are rooted in the behavioural theory of the firm and the theory of the growth of the firm, strongly affect the predicted internationalization process of firms: that of gradually deepening involvement in countries which are increasingly different from the firm’s home country. The central thesis of this book builds on the same behavioural foundations, but presents a different explanation of what drives internationalization decisions. In this chapter I intend to clarify the conceptual foundations for this difference.

This chapter is structured as follows. In section 2.2, I briefly introduce the behavioural foundations of the internationalization process model. Readers familiar with the model’s behavioural underpinnings, in particular the behavioural theory of the firm and the theory of the growth of the firm, may want to jump directly to
section 2.3. There, I critically review the key assumptions of the internationalization process model regarding what drives internationalization decisions. Two conceptual problems of the internationalization process model are highlighted: the primacy of objective knowledge and the link between uncertainty and country differences. Section 2.4 presents two notions from the literature on organizational decision-making which internationalization process theory overlooks, but which are of use in addressing these problems. Section 2.5 subsequently discusses how these suggestions can be integrated in the internationalization process model through the notion of familiarity perceptions.

2.2 The behavioural foundations of the internationalization process model

The internationalization process model explicitly builds on two theories of organizational behaviour: the behavioural theory of the firm (in particular Cyert and March, 1963) and the theory of the growth of the firm developed by Edith Penrose (1959). The behavioural theory of the firm deals with organizational decision-making, while the theory of the growth of the firm discusses the factors that propagate organizational growth and the factors which limit the rate at which organizations grow. These themes both feature prominently in the internationalization process model. Both theories were developed in response to the neoclassical view of the firm as a rational and optimizing entity with perfect knowledge of all available alternatives and their consequences (in other words, their costs and benefits). And despite obvious differences between the two theories, both start from the premise that in order to understand economic behaviour, we need to focus on the firm’s internal processes. In this section I will briefly discuss each theory, highlight the elements of each on which the internationalization model builds, and discuss how these affect the internationalization pattern predicted by internationalization process theorists.

2.2.1 The behavioural theory of the firm and internationalization process theory

Together with Simon’s (1945) *Administrative Behavior* and March and Simon’s (1958) *Organizations, A Behavioral Theory of the Firm* (Cyert and March, 1963) is one of the foundational works of the Carnegie School. Together, these complementary works formed the starting-point for the development of the behavioural theory of the firm (Argote and Greve, 2007). But while almost all ideas of the Carnegie school eventually influenced the development of the internationalization process model, as noted by Madsen (2005) most internationalization process research—including Johanson and Vahlne (1977)—refers to Cyert and March (1963). Here, I will therefore focus on their contribution.

Similar to *Administrative Behavior* (Simon, 1945) and *Organizations* (March and Simon, 1958), Cyert and March’s *A Behavioral Theory of the Firm* deals first and
foremost with the reality of organizational decision-making. It starts from the premise that,

“in order to understand contemporary economic decision making, we need to supplement the study of market factors with an examination of the internal operation of the firm—to study the effects of organizational structure and conventional practice on the development of goals, the formation of expectations and the execution of choices.” (Cyert and March, 1963: 1)

The theoretical underpinning of *A Behavioural Theory of the Firm* consists of four major concepts: the quasi-resolution of conflict, the notion of uncertainty avoidance, problemistic search, and organizational learning. In addition, the notion of bounded rationality is very much implicit. The internationalization process model explicitly builds on two of these components. The first is the notion of *uncertainty avoidance*, and the second the notion of *problemistic search*. In addition, the internationalization process model explicitly makes use of the notion of loose-coupling, which is related to the quasi-resolution of conflict. The notion of learning in the internationalization process model—with its strong emphasis on experiential knowledge—instead shows more similarities with learning and knowledge as discussed in Penrose’s *The Theory of the Growth of the Firm* than with Cyert and March’s notion of organizational learning.

The first key concept from *A Behavioural Theory of the Firm* on which internationalization process theory builds is the notion of uncertainty avoidance. The notion that decision-makers avoid dealing with uncertainty by focusing on immediate problems and challenges is reflected in the emphasis of the internationalization process model on the incremental nature of internationalization decisions. Higher market commitments are associated with higher uncertainty. Therefore, it is expected that firms opt for relatively low commitments to foreign markets until the level of uncertainty is sufficiently reduced through local learning (e.g. Johanson and Vahlne, 1977).

The second concept from *A Behavioural Theory of the Firm* that is implicit in internationalization process theory is problemistic search; the notion that organizational solutions are problem-based, and that solutions to organizational problems are sought in the area of the problem rather than in a wider context. Johanson and Vahlne (1977: 29) assume that firms act reactively rather than proactively, in that internationalization “decisions are made in response to perceived problems and/or opportunities on the market”. In line with the notion of problemistic search, they subsequently assume that “solutions to market operations problems are searched for in the neighborhood of the problem symptoms, that is in the market activities” (1977: 29). In other words, when firms experience problems in their international operations, “decision alternatives […] will be related to the operations currently performed on the market” (1977: 29).
Table 2.1: The behavioural foundations of the internationalization process model

<table>
<thead>
<tr>
<th>Key elements integrated in the internationalization process model</th>
<th>Suggested implications for internationalization processes</th>
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<tr>
<td>Uncertainty avoidance</td>
<td>Internationalization proceeds incrementally</td>
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<tr>
<td>Problemistic search</td>
<td>Preference for entry into more similar countries</td>
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<tr>
<td>Loose coupling</td>
<td>Low initial resource commitments</td>
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<td>Firms are ‘locked’ in markets once entered</td>
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<tr>
<td>&quot;A Behavioral Theory of the Firm&quot; (Cyert and March, 1963)</td>
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<tr>
<td>&quot;The Theory of the Growth of the Firm&quot; (Penrose, 1959)</td>
<td>Gradual, inevitable increases in local involvement</td>
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<td>Lateral growth through international experience</td>
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The internationalization process model thus predicts that solutions are sought locally, and that “commitments to other markets are not explicitly taken into consideration” (1977: 26). What further enhances this notion is that “the firm is viewed as a loosely coupled system in which different actors in the firm have different interests and ideas concerning the development of the firm” (Johanson and Vahlne, 1990: 12).

Uncertainty avoidance and problemistic search manifest themselves in the predictions of the model in that internationalization decisions are made incrementally, and that firms will become more and more involved in the foreign markets in which they are active. In a sense, internationalization is therefore seen as relatively self-reinforcing. Firms strive to “keep risk-taking at a low level” (Johanson and Vahlne, 1977: 27), and problemistic search causes firms to prefer to “stick to a certain market and learn more about that market rather than to try new alternatives” (Forsgren, 2002: 261). This then results in more experiential knowledge, which reduces uncertainty, which in turn leads to additional market commitments. In other words, “the model expects that the internationalisation process, once it has started, will tend to proceed regardless of whether strategic decisions in that direction are made or not” (Johanson and Vahlne, 1990).

2.2.2 The theory of the growth of the firm and the nature of knowledge

Penrose’s (1959) Theory of the Growth of the Firm has been similarly influential on the development of internationalization process theory. Penrose explored the internal factors that cause firms to grow, and the internal factors that simultaneously limit a firm’s growth rate. Penrose’s contribution generated many important insights which later informed the development of the resource-based view of strategic management. Examples are the notion that excess resources and experience are important drivers of growth, and that scarcity of both resources and managerial capacity naturally limits the growth rate of firms.

The main element from The Theory of the Growth of the Firm which has influenced internationalization process theory is Penrose’s discussion of knowledge, in particular her distinction between objective knowledge and experiential knowledge. Penrose argues that knowledge can be acquired in two different ways: by means of studying and by learning from experience. The first leads to knowledge which is relatively objective in nature; it is not intimately connected with a person’s personal experience, but instead takes the nature of facts or statements which can be learned and passed on. In other words, it is relatively transmissible.

Learning through experience instead results in experiential knowledge. This is knowledge which due to its nature cannot be easily passed on, but can only be acquired by being personally involved in a certain activity. Johanson and Vahlne (1977) emphasize that experiential knowledge is particularly important to
internationalizing firms as, in contrast to domestic firms, foreign entrants initially lack such basic experiential knowledge. Local experience provides a “framework for perceiving and formulating opportunities” (1977: 28) and therefore is an important enabler of growth (cf. Penrose, 1959). At the same time, experiential knowledge can only be acquired by operating internationally, and therefore the lack of experiential knowledge also is a naturally inhibiting obstacle to international neophytes.

Johanson and Vahlne (1977) make a second distinction, which is based on knowledge content: that between general knowledge and market-specific knowledge. While general knowledge has to do with “marketing methods and common characteristics of certain types of customers, irrespective of their geographic location” (1977: 28), market-specific knowledge refers to “knowledge about characteristics of the specific national market—its business climate, cultural patterns, structure of the market system, and, most importantly, characteristics of the individual customer firms and their personnel” (1977: 28). Johanson and Vahlne argue that while both general and market-specific knowledge are required to operate foreign operations, market-specific knowledge is mainly acquired through local experience. Knowledge of foreign operations—or international business knowledge (Eriksson, Johanson, Majkgård and Sharma, 1997)—on the other hand is considered to be relatively objective and transferable from one country to another, and therefore less strongly linked with local experience.

This distinction between transferable internationalization knowledge and non-transferable (but vital) experiential local market knowledge, has important implications for the internationalization pattern predicted by internationalization process theory:

“Experiential knowledge is […] assumed to be the primary way of reducing market uncertainty. Thus, in a specific country, the firm can be expected to make stronger resource commitments incrementally as it gains experience from current activities in the market” (Johanson and Vahlne, 1990: 12; emphasis added).

In other words, within foreign markets, an increase in international activity is mainly explained by an increase in local experience. Instead, as local experience can only be transferred to other markets with great difficulty, expansion into subsequent foreign markets is almost entirely explained by international experience in general. Or, in the words of Johanson and Vahlne (1977: 28): “It is the diffusion of this general knowledge which facilitates lateral growth; that is, the establishment of technically similar activities in dissimilar business environments” (1977: 28).
2.3 A critique of the theoretical foundations of internationalization process theory

While internationalization process theory has been the frequent subject of empirical studies, the number of studies that critically review its theoretical underpinnings is limited. Two notable exceptions are Andersen (1993), who evaluates the strength of internationalization process theory as a theory, and Forsgren (2002), who critically reviews how learning is conceptualized in the internationalization process model.¹ Instead, the following sections focus on two of the model’s key assumptions regarding what drives internationalization decisions; the primacy of true knowledge in decision making and the link between country differences and uncertainty.

Critique I: The primacy of knowledge

The internationalization process model views a lack of knowledge as a key constraint to international growth. The reason is that knowledge is seen as a key requirement for commitment decisions: Knowledge and information of local problems and opportunities initiate decision making (cf. problemistic search) and provide the firm with alternative solutions to such problems and opportunities (Johanson and Vahlne, 1977). In addition, “experiential knowledge is also assumed to be the primary way of reducing market uncertainty” (Johanson and Vahlne, 1990: 12), and a lack of local knowledge therefore inhibits larger resource commitments. A lack of knowledge is therefore seen as one of the main impediments to international expansion.

A key starting point of the central argument in this thesis is that from a behavioural perspective, the assumption that internationalization decisions are primarily based on knowledge alone is unnecessarily restrictive. Decisions are not merely based on the (often limited) information and knowledge available to decision makers, but also on the basis of beliefs: concepts such as assumptions, stereotypes, and prejudices which are held to be true, and which therefore may just as much affect decision making and the perception of uncertainty as does knowledge.

This point is widely recognized in epistemology—the strand of philosophy which deals with the nature of knowledge—where knowledge is often considered a subset of belief. Two criteria which are commonly used to set knowledge apart from other beliefs are that knowledge is true (i.e. a truth), and that believing it to be true is justified, in the sense that a knower should have an adequate indication that a belief is true (Moser, 2002). In other words, while all knowledge can be considered true, beliefs may be true, and true beliefs only become knowledge once such beliefs are justified. The

¹ The central gist of Forsgren’s argument is that as there are alternative mechanisms through which market knowledge may be acquired, the importance of experiential learning is reduced. This may enable internationalization to take on a less incremental nature than predicted by internationalization process theory.
point here is that beliefs “do not have to be justified or true to affect decisions” (Markóczy, 1997: 1230); we merely need to believe something to be true. The implication for internationalization process theory is that if we assume that internationalization decisions may be based on both actual knowledge and beliefs which are not necessarily justified nor true (but can be), then the mere lack of knowledge does not necessarily impede the internationalization process of firms.

**Critique II: The link between uncertainty and country differences**

In internationalization process theory, the concept psychic (or psychological) distance is used to explain why firms select some foreign markets over others. Psychic distance links the uncertainty experienced towards potential host countries to the extent to which local conditions resemble the home country. Thus, it is predicted that firms will initially select countries which are relatively similar to the home country before increasingly less similar (i.e. psychologically more distant) countries are entered. But while psychic distance is a potentially useful construct in explaining and understanding internationalization processes, there are several crucial conceptual problems with the suggested link between country differences and the uncertainty associated with internationalization decisions.

The first problem has to do with the concept of psychic distance itself. Johanson and Wiedersheim-Paul (1975: 208) define psychic distance as the “factors preventing or disturbing the flows of information between firm and market.” What follows are examples of factors which prevent the flow of information—essentially various forms of country differences, such as cultural and political differences—but there is hardly any further elaboration of the concept itself. For example, little attention is paid to exactly how psychic distance works as a perceptual filter, and how it affects the uncertainty associated with different foreign contexts. In fact, we could say that psychic distance is a concept which is mainly defined in term of its potential antecedents: country differences. As a result, it is unclear exactly how country differences affect psychic distance, and how psychic distance subsequently affects the uncertainty associated with location decisions. Johanson and Vahlne (1990) do allude to the ease with which foreign contexts can be understood, but essentially the link between psychic distance, uncertainty, and location decisions is underdeveloped.

A related issue is that due to considerable vagueness regarding the psychic distance concept, it is by no means certain that country differences are the main drivers of psychic distance. The lack of a clear conceptualization in effect pre-empts any discussion on the key factors affecting the psychic distance experienced towards foreign countries, which is reflected in the literature on psychic distance. For example, while there are several excellent recent studies that focus on whether or not there is a psychic distance effect (e.g. Dow, 2000; Ellis, 2007), whether we should work with perceived or objective country differences (Dow, 2000; Evans, Treadgold, and
Mavondo, 2000) and how country differences can be operationalized (Dow and Karunaratna, 2006), thorough discussions on whether there are other factors besides country differences affecting the psychological distance experienced towards countries are largely absent. As a result, it could very well be that in addition to the examples of country differences provided by Johanson and Wiedersheim-Paul (1975) or Johanson and Vahlne (1977; 1990) there are factors other than country differences affecting psychic distance (and hence, location decisions).

A third issue concerning the relation between country differences and uncertainty is that the internationalization process model is somewhat inconsistent in what affects the uncertainty associated with internationalization decisions. Across foreign markets, the internationalization process model attributes a central role to country differences. These are claimed to negatively affect the uncertainty experienced towards countries (e.g. Johanson and Vahlne, 1990) and the readiness of firms to enter a foreign market. Within foreign markets however, the uncertainty experienced by foreign entrants is primarily attributed to a lack of knowledge. This inconsistency, which stems from many of the problems identified above, can only be resolved by reconsidering the two key assumptions reviewed in this section, namely the assumption that commitment decisions are closely linked to actual knowledge, and the idea that country differences constitute the main source of uncertainty in location decisions. Two notions from the organizational decision making literature may prove helpful here.

2.4 Suggesteds from the literature on organizational decision-making

While the internationalization process model explicitly builds on theories of organizational behaviour (see section 2.2), the model largely overlooks two key notions from the literature on organizational decision-making; namely, the notion of bounded rationality and the role of cognition in perception. These notions offer valuable suggestions on how the issues discussed in the previous section can be addressed.

*Bounded rationality*

The internationalization process model, which has its origins in the late 1960s (e.g. Carlson, 1966), is quite consistent with behavioural explanations of organizational decision making at the time. The model closely reflects the notion that firms do not have perfect knowledge of all available options and their consequences, which is one of the basic ideas to emerge from the Carnegie School. It is also the starting point of Simon’s notion of bounded rationality, which claims that “human behavior is intendedly rational, but only boundedly so” (1997 [1947]: 88). The concept of bounded

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2 See Brewer (2007) for an exception.
rationality is very much implicit in Cyert and March’s (1963) *The Behavioral Theory of the Firm*, on which the internationalization process model builds. However, the internationalization process model builds on an early and narrow interpretation of bounded rationality and, as a result, adopts a rather limited view of the factors affecting human decision-making.

Simon introduced the concept of bounded rationality in recognition that decision makers often do not have perfect knowledge and understanding of all available options and their consequences. In addition, Simon argues that decision makers have only limited cognitive capabilities, which limits their ability to process information and to conceive alternative solutions. However, while decisions may therefore not always be optimal, decision makers nonetheless *intend* to act rationally given these boundaries to rationality. Simon first addressed the boundaries of rationality in *Administrative Behavior* (1947) and first used the phrase ‘bounded rationality’ in 1957 (Klaes and Sent, 2005). Since coining the term bounded rationality, however, Simon’s own conception of rationality and decision making gradually evolved. In particular, Simon more and more came to emphasize that human action is based on the limited amount of actual information and knowledge available *as well as* the additional assumptions and beliefs which complement our understanding of reality (Klaes and Sent, 2005; Simon, 1991).

As the internationalization process model has remained relatively unchanged since the 1970s, it does not reflect the gradual change which the concept of bounded rationality has undergone. Instead, the internationalization process model continues to merely view a lack of knowledge as a key constraint to organizational decision-making. This emphasis on limited knowledge in fact corresponds more closely with the notion of *intentional* rationality—the more narrow interpretation of bounded rationality used in transaction cost theory (e.g. Williamson, 1981)—than Simon’s conception of bounded rationality. In doing so, the internationalization process model overlooks that in addition to (or even in the absence of) actual knowledge and information, decisions are also informed by subjective assumptions and beliefs. A recurring theme in this book will be that acknowledging that both knowledge and beliefs have a bearing on internationalization decisions may help us explain a much wider range of internationalization patterns.

*Psychic distance as a cognitive phenomenon*

The second notion which we can take from the early literature on organizational decision making (e.g. March and Simon, 1958), as well as from cognition research, is that perceptions are inherently linked to the knowledge structure and cognitive processes of decision makers. Knowledge structures transform and order information from the environment (Walsh, 1995), and give rise to the managerial perceptions and internal representations on which decisions are based (e.g. Anderson and Paine, 1975;
### Table 2.2: Illustrative quotations from the literature on internationalization process theory and organizational decision-making

<table>
<thead>
<tr>
<th>Quotations from internationalization process theory</th>
<th>Quotations from the literature on organizational decision-making</th>
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<tr>
<td>On the primacy of knowledge in decision-making</td>
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<td>“There is a direct relation between market knowledge and market commitment” (Johanson and Vahlne, 1977: 28)</td>
<td>“behavior is determined by the irrational and nonrational elements that bound the area of rationality” (Simon, 1947, 1997: 323)</td>
</tr>
<tr>
<td>“That internationalization decisions have an incremental character is, we feel, largely due to this lack of market information and the uncertainty occasioned thereby” (Johanson and Vahlne, 1977: 26)</td>
<td>“By boundary conditions I mean the assumptions that have to be made” (Simon, 1991: 83)</td>
</tr>
<tr>
<td>“In our model, knowledge is of interest because commitment decisions are based on several kinds of knowledge.” (Johanson and Vahlne, 1977: 27)</td>
<td>“humans […] behave rationally, if at all, only relative to some set of “given” characteristics of the situation. These “givens” include knowledge or assumptions” (March and Simon, 1958, 1993: 172)</td>
</tr>
<tr>
<td>“lack of knowledge due to differences between countries […] is an important obstacle to decision making” (Johanson and Vahlne, 1977)</td>
<td>“To understand managerial processes in use, the presuppositions employed in deciding and acting must be understood” (Gioia, 1986: 349)</td>
</tr>
<tr>
<td>“firms enter new markets with successively greater psychic distance […] There they will see opportunities, and there the perceived market uncertainty is low” (Johanson and Vahlne, 1990: 13)</td>
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<tr>
<td>“because of lack of knowledge about foreign countries and a propensity to avoid uncertainty, the firm starts exporting to neighbouring countries or countries that are comparatively well-known and similar with regard to business practices etc.” (Johanson and Vahlne, 1975: 306)</td>
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<tr>
<td>“the perception of factors external to the boundary manager is a key factor in accounting for different decision frameworks and resulting strategies in the same objective environment” (Anderson and Paine, 1975: 813)</td>
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<tr>
<td>“the perception of the need for information as an indicator of uncertainty [is] important to understanding the [strategy] formulation process” (Anderson and Paine, 1975: 814)</td>
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<td>“An explanation of problem solving is grossly incomplete if it does not account for what goes on in understanding the problem, or, what amounts to the same thing, in forming an internal representation of it.” (Simon, 1991: 228)</td>
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Internationalization Decisions

Stubbart, 1989; and Weick, 1979). How and what we perceive is therefore strongly linked to the content and structure of our knowledge structure.

This notion offers valuable leads for understanding the roots of psychic distance and the uncertainty decision makers experience towards countries. Unlike for example geographical distance or cultural distance, psychic distance is not absolute. It is a cognitive phenomenon, a subjective perception, and therefore not constant. Perceptions are not merely based on the information that reaches the decision maker; this information is processed, altered, and complemented by the observer’s cognition. What results is not a watered-down version of the actual situation but the decision-maker’s own ‘definition of the situation’ (March and Simon, 1958); a mental representation, a projection. This is what accounts for the subjective nature of psychic distance.

The implication is that what causes decision makers to perceive some countries as psychologically more distant than others is intimately linked to the knowledge structure of decision makers. Therefore, variation in the uncertainty experienced towards countries requires a cognitive explanation and cannot—or not merely—be explained in terms of the extent to which countries resemble or differ from each other. In other words, we need a cognitive explanation of what affects the uncertainty associated with location decisions. This offers an opportunity to reconcile the inconsistency in what affects the uncertainty associated with internationalization decisions.

2.5 Rethinking internationalization process theory: familiarity perceptions as a unifying concept

Internationalization process theory has a long history as the dominant behavioural perspective on internationalization processes. However, as discussed in section 2.3, several conceptual problems limit the type of internationalization processes which the internationalization process model can account for. As suggested in the previous section, these problems can be addressed by taking note of the suggestions from the literature on organizational decision making discussed above.

What follows from the preceding discussions is that it is not what we know, but what we think we know on which decisions are based. In addition, managerial perceptions are closely linked to the knowledge structure of decision makers. It is likely that both type of internationalization decisions—both location decisions and decisions on the degree of commitment to individual country markets—are subject to these notions. This offers scope for the development of a single concept to explain what drives internationalization decisions. In particular, these notions can be integrated by using the notion of familiarity perceptions as a central concept in understanding internationalization decisions.
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Familiarity perceptions

The notion developed in this book is that the uncertainty experienced both within and across foreign countries does not merely stem from a lack of knowledge and information, but that it is more generally related to decision makers’ perceived understanding of foreign contexts. In other words, variation in the uncertainty experienced towards foreign countries may well stem from differing familiarity perceptions, which could be defined as decision makers’ self-perceived understanding of foreign host contexts. The difference with the internationalization process model lies in that decision makers may perceive foreign host contexts as relatively familiar despite a lack of actual experience, knowledge, and an actual understanding of these host contexts. Unsubstantiated beliefs, such as assumptions and generalizations, complement our understanding of reality and thus may partially compensate for a lack of actual knowledge. As perceived understanding and uncertainty are inversely related, decision makers who perceive a foreign host context as relatively familiar—be it due to actual knowledge, strong beliefs, or a combination of both—may experience less uncertainty than decision makers who perceive the same host context as less familiar, whether these differences in perceived familiarity are justified or not.

The notion of familiarity perceptions closely reflects the suggestions from the literature on organizational decision-making discussed above, and it may help address some of the conceptual problems with the internationalization process model identified earlier.

First, the notion of familiarity perceptions recognizes that both knowledge and beliefs may have a bearing on internationalization decisions, and that a lack of knowledge is therefore not necessarily as inhibitive to internationalization processes as internationalization process theory suggests. This corresponds closely both with current views in epistemology (see e.g. Moser, 2002) and with the notion of bounded rationality (e.g. Simon, 1947; 1991). Thus, incorporating the notion of familiarity perceptions may lead to a more realistic representation of the factors affecting decision making under uncertainty. As discussed in later chapters this may widen the theoretical scope of internationalization process theory, which is currently confined to incremental internationalization processes.

In addition, by establishing a link between decision makers’ perception of foreign host contexts and the uncertainty associated with internationalization decisions, the notion of familiarity perceptions provides a much needed cognitive explanation of uncertainty perceptions. This offers a starting point for a conceptual reconsideration of the psychic distance construct, which is potentially useful but whose effect on internationalization decisions has not yet been conclusively established in empirical studies.

Finally, the notion of familiarity perceptions provides a single explanation of what causes the uncertainty experienced towards foreign host contexts by those
involved in internationalization decisions. It therefore increases the internal consistency of the internationalization process model, which currently relates the uncertainty experienced within foreign markets to a lack of knowledge while relating the uncertainty experienced across countries to country differences.

**Figure 2.1:** Schematic representation of the internationalization decision process

*Emerging research directions*

The notion of familiarity perceptions offers a theoretically grounded solution to some of the conceptual problems of the internationalization process model. However, suggesting familiarity perceptions as a central concept for understanding internationalization decisions also gives rise to many new questions. Three of these emerging research directions are addressed in the following chapters.

One of the first questions to come to mind is whether country differences really are as strongly linked to uncertainty perceptions as internationalization process theory assumes. The notion of familiarity perceptions suggests that the uncertainty experienced towards countries is strongly related to decision makers’ perceived lack of understanding of foreign host contexts. It is unclear how country differences feature here, and why country differences should be expected to be the main (and only) antecedents to psychic distance. At the least, the notion of familiarity perceptions suggests that the link between uncertainty and country differences is not straightforward; especially since familiarity perceptions can be expected to bridge country differences. Chapter 4 takes up this theme by examining the extent to which both country differences and historical ties—a variable associated with familiarity perceptions—affect the location of foreign investment. In preparation of the study in
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Chapter 4, Chapter 3 focuses the development of a measure of institutional country differences; a dimension which has received much attention recently, but for which an appropriate country-level indicator is markedly absent from the international business literature.

A second research theme which emerges is the effects of familiarity perceptions on entry-mode decisions. Due to the assumption that a lack of local knowledge defers high commitments upon entry, the internationalization process model has long assumed that inexperienced firms only gradually increase their commitment to foreign markets. As a result, the notion of committed entry modes has mostly belonged to the realm of transaction cost theorists. Yet forming beliefs about foreign host contexts requires no actual experience. At the very least, this means that the uncertainty experienced towards a foreign host context is not necessarily as high as the internationalization process model assumes. An important question therefore is whether the notion of familiarity perceptions allows for a behavioural explanation of committed entry modes. This is one of the topics of the case study in Chapter 5.

A third research direction is how learning processes affect familiarity perceptions, and how this affects the dynamics of internationalization processes. Internationalization process theory characterizes learning of foreign markets and foreign host contexts as a cumulative and gradual learning process, which progressively lowers the uncertainty firms experience locally. Acknowledging that uncertainty perceptions are affected by both knowledge and beliefs (i.e. the degree of perceived familiarity) complicates this picture. As the beliefs decision makers hold are unsubstantiated, initial preconceptions may prove to be either true and accurate, or incorrect. The implication is that the relation between local learning and the uncertainty firms experience is not unequivocal. For example, when initial beliefs and assumptions regarding the nature of markets and host contexts prove incorrect, perceived familiarity can be expected to decrease. Therefore, local experience may lead to an increase (rather than decrease) in the uncertainty firms experience towards a foreign market environment. The implications of such (un)learning processes, in particular how internationalizing firms respond to exposed knowledge deficiencies, is the second topic addressed by the case study in Chapter 5.

2.6 A summary and some concluding remarks

The internationalization process model, which builds on both A Behavioural Theory of the Firm (Cyert and March, 1963) and Penrose’s (1959) theory of the growth of the firm, has remained relatively unchanged since the 1970s. This is surprising for two reasons. First, a considerable amount of empirical research has been dedicated to testing the model’s predictions, and empirical results have often been conflicting (see section 1.3). Second, the model’s assumptions, which strongly influence the type of
Internationalization processes the model predicts (and which it can account for), are very much open to discussion. While others have focused on the model’s assumptions regarding organizational learning (e.g. Forsgren, 2002), this chapter offered a critique of two of the model’s assumptions regarding internationalization decisions; namely, the importance of knowledge, and the link between country differences and uncertainty. In addition, this chapter pointed to the model’s inconsistency regarding the roots of the uncertainty associated with internationalization decisions.

The critique developed in this chapter can be summarized as follows: First, the assumption that internationalization decisions are based on a firm’s actual knowledge of local conditions and that commitments are postponed in the absence of such knowledge, is unnecessarily restrictive. In overemphasizing the role of experiential knowledge, the internationalization process model ignores that other factors also have a bearing on decision making. Second, the proposed link between country differences and uncertainty, for which the internationalization process model makes use of the concept psychic distance, is underdeveloped and unconvincing. The lack of a proper conceptualization of the psychic distance construct hampers discussions on the factors affecting psychic distance other than country differences. Finally, the internationalization process model is inconsistent in what is at the source of the uncertainty associated with internationalization decisions. While the uncertainty firms experience within countries is related to a lack of knowledge, across countries it is linked to country differences.

The internationalization process thus overlooks key notions from the literature on organizational decision-making. In particular, the internationalization process model overlooks that decisions are based both on the limited knowledge and information available as well as on the beliefs and assumptions which decision-makers hold to be true (e.g. Simon, 1947; 1991). In addition, in the model’s discussion on the uncertainty firms experience towards alternative host countries, the internationalization process model underemphasizes that, as a perception, what causes decision-makers to perceive some countries as psychologically more close or distant than others is intimately linked with decision-makers’ knowledge structure. Understanding such differences therefore requires a cognitive explanation.

In this chapter it was proposed that these notions can be quite easily incorporated in the internationalization process model by recognizing the notion of familiarity perceptions as a central concept. The perception of familiarity refers to decision makers’ self-perceived understanding of foreign markets and foreign host contexts, which stems from both the actual knowledge decision makers have and the beliefs that are held to be true on the nature of such markets and their contexts. It was suggested that as perceived understanding and uncertainty are inversely related, a lack of perceived familiarity with foreign markets and host contexts forms the main source of uncertainty when it comes to internationalization decisions. As both location decisions and decisions on the degree of local involvement are essentially commitment
decisions, familiarity perceptions may affect both and hence may serve as a unifying concept in behavioural explanations of internationalization decisions.

While adopting the notion of familiarity perceptions raises several new questions and opens up new research directions (three of which are explored in the next chapters), recognizing the notion of familiarity perceptions as a central construct in internationalization decisions could significantly broaden the theoretical scope of the internationalization process model. Due to the assumption that a lack of knowledge is a key inhibiting factor to internationalization, the theoretical scope of internationalization process theory is currently confined to gradual internationalization processes. By easing this constraint, internationalization process theory might be able to provide a behavioural explanation of internationalization processes that proceed less gradually. In addition, the notion of familiarity perceptions may go a long way in opening up ongoing (but quite myopic) debates on the effects of country differences on location decisions. Exploring the value of the concept of familiarity perceptions in understanding internationalization decisions, as well as uncovering its implications, will be the underlying rationale of the following chapters.