Chapter 5

Internationalization and MNE responses to unlearning—The case of a German publishing house

5.1 Introduction

In a sample of 38 Canadian firms which had undergone some form of post-entry mode change in their foreign operations, Calof (1993) noted that 39% of the mode change decisions were primarily based on gut feel and subjective beliefs about the foreign market environment. Another 28% of the mode change decisions were based on a combination of both gut feel and rational decision-making. From the perspective of internationalization process theory, Calof’s observation is interesting for at least two reasons. First, his observation challenges the assumption that decisions on the degree of foreign involvement are primarily based on the actual knowledge firms have of foreign markets (Johanson and Vahlne, 1977; Johanson and Wiedersheim-Paul, 1975). Second, his observation draws attention to the question how MNEs respond when the subjective beliefs and assumptions on which such internationalization decisions are based, are disconfirmed.

The aim of this chapter is to draw attention to the implications of these issues for internationalization process theory, and for its predictions regarding the expansion within foreign markets in particular. The argument developed here is that several key assumptions of internationalization process theory regarding the relation between knowledge and uncertainty should be reconsidered, and that this is required in order for internationalization process theory to remain a viable behavioural alternative to efficiency-based theories. In particular, in this chapter it is argued that by focusing too narrowly on the accumulation of actual knowledge, internationalization process theory has overlooked the uncertainty-reducing effects of both knowledge and prior beliefs and assumptions. This, it is argued, unnecessarily limits the explanatory power
of internationalization process theory regarding entry mode selection and location decisions.

In addition, by emphasizing the importance of experiential knowledge in understanding foreign markets and contexts, internationalization process theory overlooks the effects of unlearning on internationalization processes. The implications of such unlearning processes—the organizational responses they elicit—have received surprisingly little attention, yet a small but increasing number of studies indicate its importance. In this chapter, it is therefore argued that internationalization is better conceptualized as a process involving both the accumulation of internationalization knowledge and local market knowledge (Eriksson, Johanson, Majkgård, and Sharma, 1997), and the unlearning of the unsubstantiated beliefs and assumptions which are initially held true regarding the nature of foreign contexts, and regarding the international industry requirements.

In this chapter, I illustrate these arguments and take their development further by presenting an embedded case study on the internationalization process of a major German publishing house into Central Eastern Europe and Russia. The German publisher’s inter-nationalization process is characterized by high-commitment entry modes and by fundamentally different responses to the disconfirmation of key assumptions in the Hungarian and the Russian market, suggesting interdependence between knowledge type and MNE response. The presentation of the case is followed by a discussion of the case findings, and by a discussion of the potential implications for internationalization process theory. This is followed by several suggestions for future research.

5.2 Knowledge, uncertainty, and familiarity perceptions

Among the predominantly economics-based theories of international firm behaviour (see Chapter 1), the internationalization process model is an exception in that it attempts to offer a behavioural explanation of both foreign market selection and the degree of foreign market involvement. Internationalization process theory (IPT) posits that a lack of knowledge is one of the key deterrents to the commitment of resources to foreign markets (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahnele, 1977; 1990): a lack of foreign market knowledge is argued to limit a firm’s ability to accurately spot problems and opportunities, while a lack of international experience hampers a firm’s ability to successfully organize its activities abroad (Eriksson, Johanson, Majkgård, and Sharma, 1997). The uncertainty resulting from a lack of knowledge is argued to defer the commitment of resources, especially in the initial phases of a firm’s internationalization process. As a result, the international
neophyte is expected to initially favour less-committed modes of operation\(^1\), which limit the firm’s exposure to the unfamiliar foreign context.

The distinction is made between knowledge which is objective and therefore relatively transferable, and knowledge which is much more tacit and therefore hard to acquire other than through experience. It is argued that contextual knowledge of foreign markets is particularly tacit, and therefore not easily transferred between firms or individuals, or from one country to another. The tacitness of contextual knowledge is illustrated by the study of Eriksson et al. (2000), whose findings suggest that experience in diverse foreign markets positively affects internationalization knowledge, but not (directly) local business and institutional knowledge. To some extent, it is therefore assumed that internationalization knowledge is transferable, which eases subsequent foreign entries, while contextual business and institutional knowledge is considered too context specific to be transferred.

The argument developed here is that some of the most pressing empirical and conceptual concerns with internationalization process theory stem from the fact that while cognitive learning is implicit in internationalization process theory, its implications are underdeveloped. First, by assuming that entry-mode and mode change decisions are primarily based on actual knowledge, internationalization process theory overlooks that in the absence of actual knowledge of a foreign market environment, key decision makers may still hold subjective beliefs and assumptions about the nature of a foreign host context, on which commitment decisions can be based. In other words, internationalization process theory overlooks that the knowledge structure of decision makers consists of both the actual knowledge decision makers have as well as the subjective beliefs and assumptions which decision makers hold to be true (Walsh, 1995; Markóczy, 1997). Such subjective beliefs can be expected to reduce the uncertainty experienced towards a foreign market environment, and affect decision maker’s perception of foreign market familiarity even in the absence of local knowledge. As discussed earlier (see Chapter 2), what this suggests is that a firm’s degree of market commitment may be proportional to the perception of familiarity with a foreign market environment, rather than merely to the stock of knowledge. In other words, firms which perceive new foreign markets as relatively familiar can be expected to experience less uncertainty towards these markets, and to demonstrate relatively high levels of local involvement even upon entry.

Second, the characterization of internationalization as a unidirectional ‘learning through experience process’ may be overly simplistic. As Hedberg (1981) explains, from a cognitive perspective “[u]nderstanding involves both learning new knowledge and discarding obsolete and misleading knowledge” (Hedberg, 1981: 3). When

\(^1\) The term ‘mode of operation’ is derived from the work of early internationalization process theorists (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977) and here refers to the organizational form of a firm’s involvement in a foreign market. The term ‘entry mode’ is subsequently used to denote a firm’s selected mode of operation upon entry.
operating abroad, the initial beliefs and assumptions which affected firms’ initial entry decisions, are exposed to the foreign context. While some initial beliefs and assumptions may prove to be correct, it is likely that most of the initial beliefs are eventually disconfirmed and discarded as incorrect. A study by Pedersen and Petersen (2004) on managing directors’ self-reported understanding of foreign markets illustrates this point. Pedersen and Petersen (2004) find that for up to eight years after having been assigned to a foreign position, expatriates’ self-reported degree of knowledge of the focal host environment tends to decline rather than increase. This illustrates that, from a cognitive perspective, contextual learning may encompass the unlearning of prior beliefs as much as the mere accumulation of experiential knowledge. As a result, MNEs may unexpectedly experience post-entry knowledge deficiencies.

5.3 The case of a German publishing house

This chapter applies an embedded case study on the internationalization process of German publishing house “Altona”—a pseudonym—to illustrate these arguments, and to take the development of their implications further. The descriptive and illustrative power of case studies has been recognized as a valuable tool in inductive theory building (Siggelkow, 2007); especially since case studies have the potential to “provide freshness in perspective to an already researched topic” (Eisenhardt, 1989: 548). Striking about the Altona case is the counter-intuitive selection and persistence of relatively high-commitment entry modes in markets of which Altona had very little prior knowledge. The focus here is therefore on the motivation for the selected entry modes, and on the alternative organizational responses Altona employed to the disconfirmation of several key assumptions.

Data for the case study was obtained from a variety of primary and secondary sources. Interview data was obtained through both personal and telephone interviews, which were semi-structured, and which ranged from 50 minutes to over two hours. Interview topics covered entry mode selection, subsidiary development, the perceived degree of familiarity at the time of entry, and the perception of foreign markets, among others. Most interviews were digitally audio-recorded with permission of the respondents, which greatly facilitated the reproduction and writing down of illustrative anecdotes. The selected respondents, which included the director of Central Eastern Europe, local CEOs and local managing directors, had all been personally involved in the setting up and/or the subsequent development of a local subsidiary.¹ Data obtained from secondary sources included newspaper articles

¹ This includes the Hungarian subsidiary, which was set up as early as 1988.
collected electronically through the LexisNexis online database and copies of newspaper cut-outs collected at the (former) Hamburgisches Weltwirtschaftsarchiv. This was complemented with corporate publications, such as press-releases (available online) and annual reports.

A brief historical overview

With over 10,000 employees, a portfolio of over 50 magazines in its domestic market alone, and advertising and circulation revenues of well over €2bn, Altona is one of Europe’s biggest newspaper and magazine publishing houses. Altona, founded right after World War II, publishes Germany’s biggest selling national newspaper—a daily tabloid known for its populist reporting—as well as a more upscale national daily. In addition, Altona also publishes several regional titles. In all, Altona has a market share of around 20% in the total German newspaper market. Although a newspaper company at heart, Altona has diversified into magazines, most notably the segments for car and computer magazines as well as TV guides, women’s magazines, and several specialist segments. Currently the newspaper segment accounts for around 60% of Altona’s total revenue, whereas the magazines segment accounts for roughly 30%.

With the gradual appointment of a new management board in the early 2000’s, the strategic focus of Altona shifted towards its international activities. Altona operates abroad through eight wholly owned subsidiaries, a joint venture, and through the licensing of many of its magazine titles. For example, its leading car magazine is licensed to 29 countries, selling over 5 million copies each month. In all, Altona titles are published in well over 30 countries worldwide.

Altona has maintained offices abroad since 1988, but while it was among the first Western publishers to enter the former Eastern Bloc, Altona has lagged behind its main competitors in terms of the development of its international activities. Compared with other leading publishing houses, Altona has a strong regional focus on Central Eastern Europe. Apart from subsidiaries in France, Spain, and Switzerland, Altona operates through wholly owned subsidiaries in Hungary, Poland, the Czech Republic, and Russia, while maintaining a strategic stake in a Romanian joint venture with Swiss publishing group Edipresse (see Box 1). Within Central Eastern Europe, Altona focuses predominantly on the Hungarian market, in which it is the leading publishing house; the Polish market, where it publishes the country’s leading daily newspaper; and the Russian market, which Altona entered in 2003. Due to the relative importance of these markets and the restricted access to Altona’s other subsidiaries, it is these three entries which are of key interest in the present study.

Figure 5.1 charts the internationalization pattern of Altona in Central Eastern Europe in terms of timing, entry mode and mode of operation. Except for the Hungarian entry in 1988, for which a partnership was formed with a local partner, Altona entered the markets in Central Eastern Europe through wholly owned
subsidaries. Not taken into account in Figure 2 are the titles Altona licenses to local publishers. Examples are the licensing of Altona’s leading car magazine *Autobahn* [another antonym] in Serbia, Estonia, and Latvia, or the licensed editions of its leading computer magazine for the Lithuanian and Bulgarian markets. Due to the low degree of actual involvement of Altona—especially since the licensing of titles is initiated by local licensees—and given that the licensing of magazine titles allows little to no room for experiential learning, Altona’s licensing of domestic titles to foreign publishers hardly classifies as foreign market entries. Licensing is therefore not considered here.⁴

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**Figure 5.1:** The internationalization pattern of Altona into Central Eastern Europe

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³ The licensing of individual titles out of Altona’s vast portfolio offers little opportunity for experiential learning, as the need for intensive monitoring of its licensees is low. The possibilities for reputation damage are limited, as are the possibilities for opportunism. This in contrast to manufacturing firms, which are often at the focus of studies that do consider licensing as an entry mode alternative (e.g. Contractor, 1984, Shane, 1994). The licensing of sensitive technology offers more scope for opportunism, and monitoring is more of an issue. It also contrasts with single-product publishing companies such as Forbes, which more intensely monitor the editorial policy of their foreign licensees due to the higher risks of reputation damage.

⁴ It should be noted that the licensing of magazines did not precede Altona’s entries into the Central Eastern European markets.
Box 1: The Romanian entry

Altona entered the Romanian market in 1999 through the acquisition of a local magazine publisher. Contrary to competitor Gruner+Jahr, Altona refrained from launching a local newspaper. Instead, Altona focused on the publishing of new magazines, among which a women’s title, a youth monthly, and two entertainment magazines.

In 2002, Altona reduced its involvement in the Romanian market by accommodating its activities in a joint venture with Swiss-owned Edipresse, in which it since holds a 40% stake. The main reason identified for the withdrawal from the Romanian market was that Altona proved to be relatively unsuccessful in launching magazines for the Romanian market (circulation numbers for its local titles appear to have ranged from 30,000 to 70,000).

The reasons given for maintaining a minority stake rather than fully withdrawing from the Romanian market point in the direction of the learning opportunity a minority stake provides in contrast with a full withdrawal. As the president for Central Eastern Europe and Southern Europe explained:

“[…] we could have also sold this business to a partner, but we said: no it’s just on the edge to be an interesting country. Twenty-something million inhabitants, so we finally decided it would have been a pity to totally leave the country. Because if you once leave by selling, you close the doors for later activities […] we are very happy now because now the entire company is leading in Romania, and it’s profitable, and we’re still there. So if one day we would like to be more active, we still have a position there in this country.”
5.4 Findings

In the following sections I first present Altona’s motivation for entering the unknown Hungarian, Polish, and Russian markets through high-commitment entry modes. Several sources of foreign market familiarity are identified, such as prejudices and gross generalizations, which appear to have reduced some of the uncertainty experienced upon entry. I then draw attention to the alternative responses of Altona to the disconfirmation of several key assumptions in Hungary and Russia. Whereas in Hungary, Altona’s wholly owned subsidiary persisted despite incorrect assumptions about the required degree of local responsiveness, in Russia the disconfirmation of key assumptions resulted in the consideration of a less committed mode of operation.

5.4.1 Entry mode selection and familiarity perceptions

Internationalization process theory predicts that a firm’s involvement in foreign markets follows an incremental process of knowledge accumulation and subsequent increases in foreign market commitment. Since a thorough understanding of foreign markets can only be gained through actual experience in these markets, initial market commitments are predicted to be modest at best. Yet contrary to what would be expected on the basis of internationalization process theory, Altona’s entries into the Central Eastern European markets are mostly characterized by high initial market commitments in the form of wholly owned subsidiaries (see figure 5.1). Although actual knowledge of these foreign markets was low, most markets were generally perceived as relatively familiar upon entry, which appears to have reduced some of the uncertainty associated with these markets. There are two key reasons for the relatively low initial uncertainty experienced with respect to the Hungarian, Polish, and Russian media markets. First of all, Altona’s entry into Hungary was based on strong beliefs about the extent to which prior experiences in the German home market could be successfully translated to the Hungarian media market. Secondly, positive experiences in previously entered foreign markets started to serve as a basis for generalizations about the nature of other foreign markets; the Russian market in particular.

The Hungarian Entry

Altona’s entry into the Hungarian market in 1987 is consistently described as opportunity-driven rather than strategy-driven. Following the early transitional changes in Hungary, which opened up the local media market to foreign investors, the board of Altona was brought into contact with a local entrepreneur through the personal network of one of its board members. Together with the local Hungarian, who would become jointly responsible for the development of the Hungarian subsidiary, Altona set up a joint venture in Budapest. Altona quickly gained a firm
foothold in the Hungarian media industry, in particular through the acquisition of close to half a dozen regional newspapers. In all, the rationale behind the choice of location and the motivation to expand internationally was opportunity-driven. Preparations for the Hungarian entry were limited, and no extensive market research was performed. As one respondent sums up: “[i]n Hungary there was simply the opportunity, and the ex-chairman of Altona said “Oh, let’s try it; sounds interesting, the guy’s nice”.”

Altona entered the Hungarian market through a joint venture rather than through a wholly owned subsidiary due to Hungary’s restrictions on foreign ownership at the time. As the president for Central Eastern and Southern Europe explained:

“Hungary was, just for formal reasons it was a joint venture in the very beginning, because we could not own it entirely. Because, remember it was before officially the wall came down. [...] it was just a formal reason why we didn’t do this a hundred percent.”

The formation of a joint venture with a local partner did however conveniently compensate for knowledge-deficiencies at both partners. In pre-transition Hungary,

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**Box 2: The Hungarian subsidiary**

Altona’s entry into the Hungarian newspaper market was effectuated when Altona gained control over half-a-dozen regional newspapers. The deal was completed amidst a struggle between the Socialist Party (an offshoot of the former Communist Party), Western media conglomerates, and the opposition parties, for control over the local media.

Altona’s entry became highly controversial, as the editorial staff of the regional newspapers officially resigned from their posts as employees of the Socialist Party, only to sign as editors for Altona the next day. Although Altona officially maintained that the regional titles were simply newly created dailies, the deal was dubbed as a case of ‘spontaneous privatization’ by Socialist Party officials.

Altona early on attempted to develop several magazines in the hobby and TV segments, distributed initially through local post offices. Distributional problems were circumvented in part by setting up an independent distribution system, while a publishing facility was created in cooperation with the Hungarian state. With Hungary moving to a free-market economy, Altona gained full control of its Hungarian operations, except for a small equity stake which remained in the hands of the local CEO.

Currently Altona is the leading publisher in Hungary, with 10 newspapers—both regional and nation-wide dailies—and well over 20 magazines. The magazines include licensed foreign business titles, as well as typical Altona titles in the car and entertainment segments, and many local titles.
knowledge of modern publishing techniques was low, and there was no tradition of independent journalism. As one German involved in the early development of the Hungarian subsidiary describes: “[Altona’s local partner and future local managing director] thought it would be good to have the big Altona company in the bag and to get all this knowledge transfer and so on and so on.” On the other hand, at the time Altona was primarily focused on its domestic market, and involving a local partner was a convenient way to compensate for a lack of internationalization experience. In addition, neither the people at Altona Headquarters nor the Germans detached locally had any actual knowledge of the Hungarian market, as the following citation illustrates in retrospect: “I wouldn’t say that Altona knew about the Eastern European markets. It was an opportunity; and obviously it was not too expensive.” And, as a German respondent involved in the early development of the Hungarian subsidiary admitted: “I only knew about Hungary what I had seen on television”.

The Polish Entry

Compared with Altona’s entry into Hungary, the Polish entry in 1994 was prepared in a more systematic manner. Following good experiences in Hungary with a strong and relatively autonomously operating local managing director, Altona duplicated the Hungarian subsidiary model in Poland. However, there was a different rationale

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**Box 3: The Polish subsidiary**

By the time Altona entered the Polish market in 1994, various small and large European publishing houses had already acquired most of the traditional domestic titles in the newspaper and magazines industry. In addition, since the costs of launching a new magazine were a mere fifth of launching a new magazine in a Western European market, numerous new titles were launched. Altona’s first Polish launch (initial circulation 1.1 million copies) was a weekly women’s magazine based on a successful domestic title.

Although Altona considered the women’s magazine a test case, it quickly became the leading magazine in its segment. This was followed in 1998 by the launch of a monthly women’s magazine. Altona subsequently moved into the segment for business magazines with the launch of licensed Polish editions of Newsweek (launched in 2001) and Forbes (2004, initially named ‘Profit’).

A move into newspapers was delayed until 2003, when Altona for the first time in years launched a daily tabloid modelled after its domestic tabloid in a foreign market. It became an instant success, replacing established newspapers such as Gazeta Wyborcza and Rzeczpospolita as Poland’s best-selling daily newspaper with a daily circulation of over 500,000. In 2006, Altona launched a similarly successful upmarket daily. In all, Altona currently claims a market share of over 40% of the Polish newspaper market.
behind Altona’s entry into the Polish market. Whereas the Hungarian entry was largely the result of a one-off opportunity, the Polish expansion was described as motivated by the personal need for achievement of one of the board members. As one interviewee explained: “[t]he board member who was in charge of foreign countries changed, and then [this board member] became board member for magazines and international businesses, and he wanted his success story.” In addition, since most of the Western European markets were already saturated, the selection of the Polish market was largely described as a negative choice. The interviewee continues:

“And then [the new board member], as I said, he became board member and he said ‘Ok, where are the markets? Ok, we failed in France and so on. Eastern Europe, growing markets, and so on. What’s the biggest market? Oh, it’s Poland. Let’s go to Poland’.”

In terms of product strategy, Altona applied a similar strategy to Hungary in focusing on strong distribution targets rather than advertising, a strategy it also largely pursued in the German home market. In terms of products however, the focus was predominantly on women’s magazines rather than newspapers. While women’s magazines are generally considered a low-risk market segment, Altona’s initial product strategy in Poland also resulted from the fact that the board member

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**Box 4: The Russian subsidiary**

Altona intended to enter the Russian market conservatively by launching two well-established, licensed publications: business monthly Forbes, and news weekly Newsweek.

While name recognition was initially seen as an advantage, Altona experienced one of the challenges high-profile foreign brands may face upon entry in Russia: the brand name Forbes had already been claimed and registered as early as 1996 by one of Russia’s most well-known brand racketeers. Altona got an early taste of the often surreal Russian business climate when the owner of the brand agreed to cede its rights to the brand name only if, in exchange, the Forbes family returned to the Russian state nine Fabergé eggs it was about to auction (estimated worth: $90m). The case was eventually settled.

In 2004 Altona launched its first local editions of both Forbes (circulation 40,000), which in its second issue included an extensive list of Russia’s wealthiest people, and Newsweek (circulation of 50,000). In July 2004, the local Forbes editor—in-chief was shot dead outside his office—an assassination which remains unsolved, but which has been linked to his work as an investigative journalist. In 2005, a licensed local edition of British design magazine Wallpaper* was launched (now discontinued), with Altona’s domestic computer title and a licensed lifestyle magazine following in 2006.
responsible for international business was also responsible for magazines, rather than newspapers.\footnote{Altona only launched its first newspaper in Poland in 2003. This daily tabloid soon established itself as the leading daily newspaper in Poland, which enticed Altona to launch another newspaper in 2006, analogous to the compact version of its more upscale daily newspaper in the German home market.}

The Russian entry

Sixteen years after entering its first market in Central Eastern Europe, in 2003 Altona entered the Russian market. Although a newspaper publisher at heart, Altona initially decided to focus on magazines rather than daily newspapers. One of the last big—predominantly German—European publishing houses to enter Russia, it faced stiff competition in the magazine segments which were regarded as the archetypical Altona segments, such as the markets for car and women’s magazines. As a result, Altona initially focused on publishing licensed international independent news and business magazines.

The entry strategy followed in Russia was based largely on the positive experience with the Hungarian model. A wholly owned subsidiary was formed which would operate under the relatively autonomous auspices of a local Russian manager. It is striking that upon entry, the Russian market was perceived as relatively familiar. One factor which fuelled this perception was Altona’s previous experience in Poland. Interviewees not based in Russia frequently made comparisons between Poland and Russia, as if market conditions were relatively comparable. Another factor was the personal experience of the manager responsible for Altona’s expansion in Central Eastern Europe: “Since I was responsible already for Poland and Russia for [a competitor], I felt that I was pretty familiar with the mentalities of Eastern Europe.”

Yet, although perceived familiarity with the Russian market was sufficiently high to warrant entry through a wholly owned subsidiary, actual knowledge of the Russian market was low. When asked to comment in retrospect on Altona’s actual understanding of the Russian market upon entry, the local manager replied:

“I have seen so many German investors and helped them to run their businesses; I would say that Altona had a typical sort of mind-set like all of them. And you learn only in reality. [...] I cannot judge Altona’s mindset. They understood that [Russia]’s an emerging market, we have to be here, they understood we have to move. But I think they underestimated the distributional situation in Russia, which is a natural bottleneck in this country [...] I think that [the president of Central Eastern and Southern Europe] for example understands in Berlin what’s going on, he used to be a general manager in Poland, [...] but Russia is not Poland, that’s another topic. More or less, it’s a learning experience.”
In fact, the lack of actual knowledge of local market conditions in Russia was such that the Russian managing director felt compelled to initiate an internal PR campaign to raise awareness of Russia at Headquarters. As she explains with respect to her initiative: “Beforehand, it was only two three people who knew “Ok, this is Russia”.”

Generalizations about Russia on the basis of Altona’s positive experience in Poland reduced some of the uncertainty associated with entering the Russian market. Yet, there were limits to the extent to which experiences in the Polish market could be reasonably generalized to the Russian market. As a result (as discussed later on) there are several examples of underestimations of local market conditions in Russia due to assumptions based on the Polish market. In all, the main reason why Altona entered (or soon established) the markets in Hungary, Poland, and Russia through relatively committed modes of foreign entry appeared to be due to the perceived familiarity with the local markets. Whereas the Hungarian entry was initially based on assumptions of similarity with the German home market, the Polish and Russian entries were largely based on generalizations of the market environments Altona had encountered earlier.

5.4.2 Sources of familiarity

Given the lack of any actual understanding of the Central Eastern European markets, Altona’s decision to opt for relatively committed entry modes is striking. However, as indicated above, what appears to have reduced at least part of the uncertainty associated with entering these unknown markets, were relatively strong preconceptions, generalizations, and outright prejudices about the nature of the markets and the broader societal contexts in Hungary, Poland, and Russia. Such subjective beliefs appear to have fuelled the perception of familiarity, thereby partially compensating for a lack of experiential knowledge.

The factors which appear to have affected the perception of familiarity with these foreign markets can broadly be grouped at three different levels. While some factors particularly affected the perception of foreign markets at the individual level, such as earlier personal experience with a foreign market, other factors, such as prior entry in seemingly similar markets, appeared to affect Altona’s perception of Central Eastern Europe at the organizational level. In addition, several factors emerged at the national level, such as media coverage, which appeared to have had an effect on how foreign countries and markets were perceived.
Internationalization Decisions

Individual level

At the individual level, several factors appear to have had a bearing on the mental representations of the countries in the former Eastern Bloc by the German managers. The following excerpt from one of the interviews illustrates how unfounded prejudices gave rise to particular mental representations of the countries in Central Eastern Europe and their nationals:

“I’m a Westerner, a Western German. So I didn’t have a clue, well not automatically, but I almost had no clue how life really was in the Eastern Bloc. I was just once or twice in East Berlin, but that was really my sole experience, live experience of the Eastern Bloc. For me, Poland, that was really the first time that I entered a country of the former Eastern Bloc. And I had many prejudices. So I imagined how the life was, and one of my prejudice was that it’s a little bit like the Third World. And when I came there I was surprised how close people were. I mean […] the standard of life. I mean it was much less than in the West […] but I was surprised. I mean, it sounds a little bit stupid but I was surprised how normal the life was, and how normal people were. I thought they were a little bit like aliens or something […] But my main surprise was they were no aliens and they were very close, and they were very keen to develop and to catch up with the development.”

In addition, factors such as a personal fascination with the region, as well as first-hand experience through tourist visits or temporary assignments, both seemed to shape and change the personal perceptions of these countries. As the president for Central Eastern Europe explains: “Since I was responsible already for Poland and Russia for Gruner+Jahr, I felt that I was pretty familiar with the mentalities of Eastern Europe.” In turn, the personal interests of the German manager of the Russian subsidiary largely shaped her perception of Russia. But while she initially presumed to be quite familiar with the political side of post-Soviet Russia, after twelve years of actual experience in Russia she had to conclude that she was still in the dark about the actual influence of Russian politics on business in Russia.

“I’m West-German, so no Russian connotation or Soviet Union background […] Politically [when I started I felt I knew the country] pretty well. I was always interested in Soviet Union literature, history, and understanding what’s going on. It’s a typical syndrome of Cold War curiosity. [But when I arrived in Russia,] I lost ten kilos in the first year. Because there was no food and I didn’t understand the system of ‘talonsky’, which is what you needed to buy products. I didn’t figure out the system that I was not officially registered, so I could only buy products and food on the free market […] Today, after 12 years I have to say yes,
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I totally understand more or less the structure of networking […] but the political sort-of Kremlin side still is a black box.”

Organizational level

In a similar manner, there are several factors at the organizational level which explain how managers at Altona in general perceived the Central Eastern European markets. These are Altona’s dominant position in the German home market, subsequent experiences in local markets which formed the basis for generalizations about other markets in Central Eastern Europe, and, to a certain extent, Altona’s historically adverse stance against the totalitarian regimes of the former Eastern Bloc.

First of all, Altona’s experience with the German home market, in which it occupies a dominant position, affected the perception of the Hungarian consumer market as well as the perceived ease with which potential obstacles could be overcome. Reflecting on Altona’s entry into Hungary in the late 1980s, a manager recalls:

“Altona underestimated the buying power. Totally. And the need to think in various product categories. Because Altona, […] with 80% of their products they work in monopolies. […] If the organization mainly works in monopolies, you don’t have this variety of consumer groups in your mind when it comes to product decisions and development decisions, and that was a problem for Altona at that time, and they had to learn it over the years. And if you look at other companies, to a certain extent they manage it better to shape special products for special markets, because they’ve been used to it, also in their home markets.”

Similarly, as described earlier, Altona’s experiences in the Hungarian and Polish market served as a basis for generalizations on the nature of the Russian market. Relatively naïve assumptions, such as on the extent to which an acquisition strategy could be pursued in Russia, or on the degree of independence with which the Russian media industry operates from political and business interests, seem to have at least reduced part of the uncertainty experienced upon entry of the Russian market.

The historically adverse stance against totalitarianism also affected both Altona’s perception of Central Eastern Europe and, in particular, how the firm was initially perceived in Hungary. The founder of Altona was fervently opposed to the totalitarian regimes in the Eastern Bloc in general, and to the division of East and West Germany in particular. This was reflected, among others, in Altona’s corporate principles, and in newspaper reports on the German Democratic Republic, which was consistently sarcastically referred to between quotation marks (“DDR”). One may therefore be tempted to consider Altona’s entry into the newly liberalized Hungarian newspaper market from a messianic perspective. However, Altona’s Hungarian entry was first and foremost an opportunistic rather than ideological decision. Yet, the public stance
against totalitarianism did reflect positively on how Altona was initially received in Hungary. A German manager recalls:

“[Altona’s publicly negative stance against totalitarianism in Central Eastern Europe] affected Altona in the beginning; or Altona, the perception of Altona. Because that’s what we heard often in the very early years, that people think and thought: ‘OK, Altona must be very good company, and they’re a friend of ours’ because of this special political wish. But this is no longer the case, as the current political problems in these countries [...] affect these people much more.”

National level

In addition to factors at the personal and organizational level, factors at the national level also appear to have influenced the perception of familiarity with the markets in Central Eastern Europe. Three factors which emerged are media coverage, national stereotypes, and historical ties.

Through media coverage, selected accounts of events unfolding abroad reach a wide domestic audience. As a source of information, media coverage therefore has a direct bearing on the perception of familiarity with these countries. Yet the selective nature of media coverage has also been found to foster particular stereotypical beliefs about foreign countries and their nationals (Eagly and Kite, 1987). Therefore, media coverage may also serve as the basis for further generalizations and subjective assumptions about the nature of a foreign country. Either way, media coverage can positively contribute to the perception of familiarity, especially when other information sources are lacking. As a manager involved in the early development of the Hungarian subsidiary indicated, when asked to reflect on his actual knowledge of Hungary prior to being transferred to Budapest: “I only knew about Hungary what I had seen on television”.

National stereotypes are the second country-level factor which affected the perception of Central Eastern Europe. In general, such incorrect preconceptions were quickly disproved. Reflecting on his initial perception of Poland, one manager admits: “The Poles are very ambitious. They’re working hard. If you ask, normally the German prejudice of Poles is that they’re not working and that they’re lazy, and they’re just stealing. But they’re very hard-working.” Yet a particularly dramatic example of a case where the exception proves the rule unfolded in Russia. The managing director for Central Eastern Europe described the case where the stereotypical image of Russia as a country where disagreements are settled through the bottle or the bullet, was tragically confirmed rather than disproved:
Chapter 5: MNE Responses to Unlearning

"We lost one editor-in-chief who was shot dead, so this was... Never, even not our Russian... At that time the managing director was a Russian lady, for years in the business, and even she; she was more shocked that the guy was shot dead than we. If you read German newspapers, and that's probably the same with Dutch newspapers, we live with the imagination, with the prejudices that people are shot dead in Russia, so I mean, that it could happen. That's not very likely, but you live with the likelihood that it could happen. But our Russian lady, she was so surprised, she was more surprised than we were; because she, as a Russian living there, she could not imagine that this still happens; that people are shot dead."

A third country level factor which appears to have had its bearing on how the Central Eastern European countries were perceived, are historical ties, such as—but not merely—the German occupation of much of the region during the Second World War. Due to this historical event, most German managers seemingly expected to be treated with a certain degree of resentment. Yet these same managers all reported that to their surprise, they had never been unnecessarily confronted with the Second World War, and none had ever been treated badly on the basis of their nationality. In fact, similar to how Altona’s perspective on the totalitarian regimes of the former Eastern Bloc reflected positively on how Altona was initially perceived in Hungary, there seemed to be a certain degree of reciprocity with respect to the effect of historical ties. The Russian managing director:

"German-Russian cultural historical ties are extremely strong. [...] We have lots of historical ties which Russians learned at school, [about the] history between Germany and Russia [...] Russians never had any sort of second thoughts about [me] being German, and never ask questions about the war, never treated me like shit, which is amazing because what we’ve done here was a disaster. And there were no, never, connotations that “Oh my god you’re German, we don’t want to work with you”. Opposite. They strongly believe in the sort-of ‘made in Germany’ quality stuff, they strongly believe that we are organized, disciplined, and that we are sometimes a little bit stubborn.”

As such, historical ties may have a reciprocal effect by enabling a form of reminding and remembering. Even when one is initially unaware of historical ties between one’s home country and a host country, one may still be reminded of a collective history through the way one is perceived by foreign nationals. Similar effects have been suggested by cognitive psychologists such as Halbwachs ([1950] 1980) who—in relation to the idea of a collective memory—suggested that “a man must often appeal to others’ remembrances to evoke his own past” ([1950] 1980: 51). What this implies is that both directly and indirectly, historical ties may shape how one perceives (and is perceived by) foreign nationals. Similar to how stereotyping may give an (often
incorrect) impression of familiarity with foreign nationals (recall for example the national German stereotype of Poles being lazy) historical ties therefore may positively affect the extent to which a foreign country is perceived as familiar.

5.4.3 Organizational responses to the disconfirmation of prior assumptions

Internationalization process theory conceptualizes the internationalization process as a gradual and unidirectional ‘learning through experience’ process. The Altona case supports such a view; however, it also illustrates that internationalization as a learning process does not necessarily imply incremental internationalization processes. Commitment decisions were not postponed until Altona had gained a reasonable understanding of local markets. Instead, the above illustrated that strong assumptions and generalizations appear to have enabled the establishment of wholly owned subsidiaries in Hungary, Poland, and Russia early on. Over time, however, many of the assumptions which had initially informed Altona’s entry decisions proved incorrect, and initial beliefs had to be revised. The following sections illustrate the different organizational responses Altona employed to the disconfirmation of key assumptions in Hungary and Russia.

An increase in autonomy for the Hungarian subsidiary

Upon entry into Hungary, it was implicitly assumed that the characteristics of the newly formed independent newspaper market, as well as the characteristics of its future customer base, were relatively comparable to the German home market. This was reflected in the confidence placed in the extent to which Altona’s knowledge and expertise in the domestic market could be translated to the Hungarian market. With respect to the magazine business however, this resulted in severe underestimations of the lack of buying power of the local populace, and an underestimation of the extent to which content and style needed to be adapted to local consumer preferences. In addition, by attempting to extend its domestic experiences to the Hungarian market, Altona failed to recognize that competing in a market less concentrated than the domestic market required a larger degree of customer segmentation and product differentiation. It took a failed launch of its popular car magazine for Altona to learn that the initial assumption ‘what works well in the domestic market can be transferred with similar success to the Hungarian market’ did not hold. This resulted not only in adaptations of Altona’s product strategies, but also in several structural adaptations, such as a larger degree of autonomy for its Hungarian subsidiary and less direct involvement of Headquarters in local operations. A German manager involved in the early development of the Hungarian subsidiary recalls:
“I very well remember the organization at that time at Altona, and the market itself or the development of markets. [...] There was the idea to transfer the Autobahn brand to the Hungarian market and, well, we had to sit together with those guys who have been for Autobahn at that time [...] so I remember a meeting when two guys from Hungary came, and I was the third guy who joined to that Hungarian team, and on the other side were sitting twenty people from the Autobahn Group. And it was all about Autobahn. So what can you do if you’re three against twenty. And I don’t want to say it was against, but you know, these twenty tell you about how Autobahn works in Germany, and what they would recommend how to build the brand, and so on and so on. And you sit there, and you think ‘Ok, nice to hear’, and ‘we think it is a good idea, brilliant’, and so on. And they convinced us to do it in this and that way, and we did it here in the Hungarian market, and it totally failed because it was the translation of the German approach to the Hungarian market. But the translation was only the language translation. All the other things like pricing, paper, page count, anything else was just identical with the German approach. And that killed us, because all the success factors of the German edition couldn’t be transferred via this approach. One example. Autobahn is the cheapest car magazine in the German market. But taking over all these parameters from the German business, this magazine was the most expensive magazine in the Hungarian market. Not only in the car market, but in the total market. So this magazine totally failed. And after that there was a kind of learning and a kind of change in the approach. The teams on the German side got much smaller, and the Hungarian teams became a little bit bigger, so the Hungarians got more and more the [dominant] position. And the more you know about your own market, the more self-conscious you are in bringing up arguments and facts and so on. So after a year it changed and it was no longer Altona Germany who said “OK, let’s do this” and “You should do that”. It was the Hungarians who said, “Ok we want to try this” and “We want to try that”.”

The experience with Autobahn strongly impacted the development of the Hungarian subsidiary. It disproved Altona’s implicit assumption that the Hungarian market could be treated as an extension of the domestic market. Instead, it signalled that in order to operate successfully in the Hungarian media market, clear knowledge of local conditions was required, as well as a much larger degree of local responsiveness and an excellent network of local contacts. In response, the local CEO was subsequently allowed to operate and develop the Hungarian subsidiary with a considerably higher degree of autonomy. In addition, less emphasis was put on the transfer of home-market knowledge and practices to the Hungarian subsidiary, and more emphasis was put on responding to local consumer preferences. Efforts were put in the development of a local printing facility, and several local magazine titles were developed.
The resulting success of allowing the local subsidiary to operate with a larger degree of autonomy was such that the ‘Hungarian subsidiary model’, in which a well-networked autonomous CEO featured heavily, was eventually to be duplicated in Poland and Russia. The large degree of autonomy granted to these local subsidiaries translated for example into the adaptation of domestic titles and the development of local titles, the adaptation of advertisement strategies to local circumstances, and the execution of local market research; in essence shifting large parts of the value chain to the local markets. In the words of the Russian managing director, while “reporting is normal, for figures, ads sales, forecasts, and stuff like that, [everything else is] local. I share the results, for explanatory reasons. But media agencies, or with whom we work or what we’re doing, no.” In general, as another manager remarks,

“The learning from Hungary was that you have to know a lot about the country, it’s political system, the demand from the market, and so on. You can only live it and you can really experience it only if you are sitting in that country and if you know how the people are behaving, how the people are working, how the agencies are working, and so on. And this is absolutely a local business, so Altona thought: this approach here, with the CEO from the country itself who has all the contacts and so on, is the best way to do it. And therefore they skipped all the ideas to implement German specialists over time in the countries itself.”

Reconsideration of the mode of operation in Russia

As discussed earlier, Altona’s entry strategy into the Russian market was largely based on the positive experiences in Poland and Hungary. A wholly owned subsidiary was decided on, and a local Russian CEO was attracted, on the assumption that the Russian market was in several respects comparable to the markets in Poland and Hungary. However, several of these assumptions, regarding for example distribution and the role of politics, gradually proved to be severe underestimations of Russia’s harsh business environment. While one would over time expect gradual increases in foreign market commitment due to the accumulation of local knowledge, the disconfirmation of several key assumptions led Altona to consider scaling back its operations in Russia, and to consider the formation of a partnership with a local partner to compensate for perceived knowledge deficiencies.

Upon entry in Russia, several statements of members of the management board, released through press releases and interviews in several media, made note of the vast size of the Russian market and of the growing middle class. Such statements illustrate the board’s ignorance of the complex distributional system in Russia, which the local managing director described as a “natural bottleneck”; both in terms of the size of the country and in terms of the sophistication of the distributional network. As a result, particularly due to overestimations of the extent to which weekly magazines could be
distributed in a timely manner, sales in Russia were less than expected. As the local managing director explains:

“The print-runs are not reflecting the potential of the country, and that’s not because we cannot print more, or we have no paper, or no content, or no team, but no distribution. Bottlenecks in distribution. Everything that goes up to Ural is OK; everything in Siberia is getting tricky, especially for weekly titles.”

Altona only gradually came to realize that the Russian independent media industry was less developed than for example the Polish and Hungarian media market. Tax regulations, for example, were more complicated, especially with regard to remissions (unsold copies) on which taxes had to be paid nonetheless. Altona also encountered unforeseen difficulties in advertising magazines through rival media channels, as the following example illustrates:

“What I dislike is television stations sort of refusing despite of a running contract, to show our advertisement because they don’t like the cover, for example. We had it yesterday, the first channel refused to show our TV spot for ‘OK!’ because there was a pop star on the cover which is a star on the second television. ‘But guys, we have a contract, so…’ - ‘Yeah but she is not working with us’. So I said: ‘I’m enhancing in advertisement our product, not yours’. That’s the sort of misunderstanding, who is paying whom.” (Managing director Russia)

The relatively positive experiences in Poland and Hungary also resulted in underestimations regarding the role of politics in the Russian media industry. In a world where the interests of politics, business, and the independent media are often both closely aligned and conflicting, politics proved to have a surprisingly large bearing on Altona’s ability to, for example, independently pursue an acquisition strategy. The president for Central Eastern Europe drew frequent comparisons between Poland and Russia. The following statement is particularly illustrative in this regard.

“We looked in the [Russian] market for let’s say tabloids or newspapers overall […] and we see that is pretty difficult, and that we, unlike for example in Hungary or in Poland, if you approach a local company and say ‘If you wanted to sell, could we buy’, you feel that it’s more difficult; that it’s a political issue, always. […] In Russia, it’s like a wall at some point. And this we certainly underestimated. […] In Poland we simply took into consideration the market, but did we contact [local politicians]? No. We didn’t fear them, and I think we didn’t take them particular into consideration. But we can’t do this in Russia. Definitely.”
Altona also learned the hard way that the thin line between politics and media implies that as one of the relatively few players in Moscow’s concentrated media landscape, Altona itself is constantly in the political limelight. This perhaps became most clear in 2006, when the December issue of one of its business magazines was initially suspended from distribution, following an article on the business interests in real estate of the wife of Moscow’s mayor. Amidst accusations of libel and the violation of journalistic ethics, Altona’s journalistic standards were widely questioned. Eventually, this experience underlined the unexpectedly short lines between business, politics, and media. The local managing director:

“The underestimation which I’ve learned painfully, and that was my personal underestimation as well, was how being in the media in Russia means you’re in the political limelight. One-hundred-and-fifty percent. That was a new experience for me in December. And this means high political limelight. […] This is a chain reaction which is not a local game, this is a game between lots and lots of different players and agendas.”

In response to the disconfirmation of many initial assumptions about the Russian market environment, Altona considered relinquishing direct control over its Russian operations. Newspaper articles appeared which claimed that Altona was looking to sell off its local subsidiary, but these reports were declined by several interviewees as incorrect. When asked whether in hindsight it would have been more convenient to enter the Russian market through a partnership rather than through a wholly owned subsidiary, the president for Southern and Eastern Europe did indicate that the formation a partnership in Russia was actually considered.

“It would have been easier to team up with a partner for business reasons. […] Which we still don’t exclude because we are always thinking and rethinking about our strategy. It might be that this is what we’re doing some day. Specifically because at some point it might be we want to launch or to acquire a newspaper. And then, for political reasons, probably, and also for business reasons it might be better to team up with a Russian partner.”

In addition to the political benefits of teaming up with a well-connected Russian partner, the formation of a partnership was seen as a possible solution to Altona’s distributional problems and to contribute to better regional access. Although Altona was still merely in the screening phase of identifying suitable partners, the formation of a partnership was perceived as a potentially more viable alternative to its wholly owned subsidiary.

In all, Altona’s accumulation of experiential knowledge was paralleled in several foreign markets by the disconfirmation and unlearning of many of the prior
assumptions which initially affected Altona’s entry mode decisions. In Hungary, the local subsidiary gained much more autonomy when preconceptions about the generalizability of the home experiences to the foreign markets were disproved. In Russia, several assumptions about the nature of the Russian market, which largely stemmed from generalizations based on Altona’s prior experience in Poland, proved to be naive underestimations of the unorthodox Russian market environment. As a result, Altona considered scaling back its Russian activities by involving a local partner in its Russian operations. Therefore, while internationalization process theory predicts that actual experience gradually allows for more committed modes of foreign operation, Altona’s experience illustrates that the accumulation of actual knowledge can be preceded or paralleled by the disconfirmation of key assumptions, which may call for a variety of organizational responses.

5.5 Discussion

Below, I first discuss why Altona—contrary to what would be expected based on internationalization process theory—opted to enter several key markets in Central Eastern Europe through wholly owned subsidiaries rather than through less committed entry modes. I draw attention to the uncertainty-reducing effects of subjective beliefs and assumptions before, following the principle of theory triangulation (Patton, 1987), contrasting my interpretation of the case findings with alternative theories on international firm behaviour—transaction cost theory in particular. I end this discussion by proposing several adjustments of the internationalization process model, which are argued to increase both the explanatory power and the internal consistency of the model. In the second part of the discussion I focus on the question why the post-entry disconfirmation of key assumptions resulted in the reconsideration of the mode of operation in some markets, and the persistence of relatively committed modes of operation in others. I develop the argument that different organizational responses can be expected depending on whether the disconfirmed assumptions pertain to characteristics of the foreign market environment or to industry characteristics.

5.5.1 The uncertainty-reducing effect of assumptions and beliefs

The Altona case illustrates the argument that the absence of knowledge may only impede the internationalization process of firms if the lack of local knowledge is not offset by vivid beliefs and preconceptions regarding the nature of foreign countries and markets. Key decisions at the time of the Hungarian entry, such as on the product strategy to be followed or the degree of autonomy to be granted to the local subsidiary, appear to have been strongly affected by assumptions of similarity between the German and the Hungarian media market. Entry decisions in Poland and, in
particular, Russia instead proved to be strongly based on the generalization of local market conditions encountered in previously entered markets. Such generalizations, which ranged from assumptions regarding local business mentalities and consumer preferences to assumptions regarding the level of development of the local distribution system, appear to have had a large bearing on the decisions to establish full subsidiaries early on.

The observation that key decisions were repeatedly based on subjective representations rather than on actual knowledge of local markets illustrates that internationalization process theory may so far have overlooked an important element of human decision-making; namely that in the absence of actual knowledge, decisions can instead be based on unsubstantiated beliefs and assumptions. As others have argued, the beliefs one holds do not have to be true in order to affect decisions (Markóczy, 1997; Simon, 1947; 1991), and subjective beliefs about the nature of a foreign market—however unrealistic they may be—may strongly influence the extent to which key decision makers perceive a foreign market as familiar. As such, both knowledge and beliefs are likely to have a direct bearing on the subsequent uncertainty experienced by foreign entrants.

A parallel can be drawn with Tsang’s (2004) study on the effect of superstitious beliefs on decision-making by Chinese managers. Tsang found that about three-quarters of his respondents relied on some form of superstition—ranging from hiring feng shui experts to consulting oracles—when faced with high uncertainty due to a lack of information. Tsang relates his finding to Malinowski’s (1948) theory on the role of superstition in societies, which posits that “superstition serves to fill the void of the unknown and to reduce anxiety” (Tsang, 2004: 96). The current study and for example the study of Calof (1993) suggest that subjective beliefs about the nature of a foreign market can be expected to have a similar effect on the perceived uncertainty towards foreign markets and foreign host contexts.

This implies that if we are to conceive the internationalization process of firms as a ‘learning through experience’ process (O’Grady and Lane, 1996), merely taking into account explicit and experiential knowledge does not suffice. Instead, we need to acknowledge that unsubstantiated beliefs and assumptions form a substantial part of the cognitive base of key decision-makers and, as the case illustrates, that subjective perceptions of foreign markets may therefore have a large bearing on initial internationalization decisions. For example, firms which perceive new foreign markets as relatively familiar due to vivid beliefs on the nature of a foreign market environment can be expected to demonstrate relatively high levels of local involvement even upon entry. In other words, a firm’s degree of market commitment may be proportional to the perception of familiarity with a foreign market environment, rather than merely to the stock of actual knowledge as internationalization process theory suggests. Taking into account both subjective beliefs and actual knowledge not only corresponds more closely with the cognitive
perspective which is already implicit in internationalization process theory, it may also extend the explanatory power of the internationalization process model to empirical observations which internationalization process theory was previously unable to account for, such as foreign market entries through wholly owned subsidiaries rather than through exporting and licensing.

**Alternative theoretical perspectives**

The dominant alternatives to the internationalization process model with respect to entry mode selection are the knowledge-based perspective, internalization theory, and the eclectic paradigm. From the perspective of the knowledge-based theory of the firm, the mode of entry is largely determined by the nature of the know-how to be transferred. The MNE is viewed as a mechanism to transfer particularly tacit knowledge across borders (Tallman, 2003), and foreign expansion is driven by the competitive capabilities of firms to successfully create, replicate, and transfer knowledge (Kogut and Zander, 1993). In a similar vein, firms with a strong technological base and a rich knowledge structure are predicted to expand internationally through start-ups rather than through acquisitions (Barkema and Vermeulen, 1998). Therefore, from the perspective of the knowledge-based theory of the firm, wholly owned subsidiaries are expected when the competitive capabilities of a firm abroad are relatively dependent on the transfer of skills and knowledge from the domestic market to the foreign market. Yet, the publishing industry was consistently described as strongly a “local business” which among others is reflected in the importance Altona attaches to well-networked local CEOs. On the basis of the knowledge-based theory of the firm, we would therefore expect an internationalization strategy which relies more heavily on licensing than on the establishment of wholly owned subsidiaries.

Both internalization theory and the eclectic paradigm essentially apply transaction cost theory (TCT) arguments with regard to entry mode selection. From a transaction cost perspective (Williamson, 1981), the commitment of resources to a foreign market is interpreted as a sign of market failure, as committed entry modes indicate that the costs of monitoring market-transactions exceed the costs of setting up and maintaining appropriate governance structures to coordinate a firm’s operations abroad. From a transaction cost perspective, Anderson and Gatignon (1986) explain, four constructs positively affect whether a considerable degree of control is desired: asset specificity, the combined effect of asset specificity and external uncertainty, internal uncertainty, and the potential for free riding by potential business partners. Based on transaction cost theory, we would expect committed modes of entry under the following conditions:
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1) when asset-specificity is high,
2) when both asset-specificity and external uncertainty are high,
3) when internal uncertainty is high, or
4) when the potential for free-riding on the basis of the brand name of the entrant is high.

Given that neither asset-specificity nor the potential for free-riding are high (note that Altona licenses titles to smaller markets such as Serbia and Latvia), on the basis of transaction cost theory one would only expect the selection of wholly owned subsidiaries in Poland, Hungary, and Russia if internal uncertainty toward these markets is high.

However, as Anderson and Gatignon note, on the basis of transaction cost theory, two alternative responses can be expected when firms are faced with high internal uncertainty. As they explain, “[i]nternal uncertainty exists when the firm cannot accurately assess its agents’ performance by objective, readily available output measures” (1986: 15). Under such circumstances, high control is needed to monitor inputs rather than outputs, which favours a relatively committed form of foreign entry such as a wholly owned subsidiary. On the other hand, “[t]he international neophyte fears the unknown, consequently overstating risks and understating returns of international markets (Davidson, 1980)” (1986: 16). Anderson and Gatignon therefore suggest that it can also be argued that internal uncertainty reduces the propensity of firms to commit the resources needed to set up and maintain more appropriate governance structures. With experience, Anderson and Gatignon argue, firms enhance their “understanding, competence, and confidence” (1986: 16), and the desired degree of control of a foreign business entity increases. Note that this is essentially the argument put forward by internationalization process theorists in the mid-1970s (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977). As Johanson and Vahlne (1990) note, their argument therefore is, essentially, a transaction cost argument.

5.5.2 Organizational responses to the disconfirmation of key assumptions and beliefs

While unsubstantiated beliefs and assumptions may often inform key internationalization decisions—recall Calof’s (1993) observation that 39% of the mode change decisions in his sample were based entirely on gut feel—most of such beliefs are essentially incorrect representations of a foreign market environment. This draws attention to the question what organizational responses MNEs employ in dealing with emerging or exposed knowledge deficiencies when important initial assumptions are disconfirmed. The Altona case illustrates two alternative organizational responses when significant assumptions prove incorrect: adaptation of the degree of market commitment (I), as was considered for the Russian subsidiary, or
(II) structural and strategic adaptation as observed at the Hungarian subsidiary. The argument developed here is that the subsequent selection of one response over the other is dependent on whether the firm experiences a discrepancy between the foreign market environment and the subjective perception of that environment, or whether the firm experiences a discrepancy between the strategic requirements of the industry and the firm’s international model.

I: Adaptation of the degree of market commitment

Internationalization process theory conceptualizes a firm’s involvement in foreign markets as a process which evolves out of the interplay between the commitment of resources on the one hand, and the accumulation of knowledge on the other (Johanson and Vahlne, 1977). Since the commitment of resources enables the accumulation of additional knowledge through experiential learning, the internationalization process is conceptualized as a strictly cumulative process, and disinvestments remain unaccounted for (Calof and Beamish, 1995). However, Altona’s Russian entry illustrates that when initial preconceptions are disproved and the accumulation of experiential knowledge has yet to take place, decision-makers may respond by limiting the firm’s exposure to the foreign market environment in response to the increased uncertainty and risks experienced towards that market.\(^6\)

This expectation requires that the disconfirmation of incorrect beliefs precedes—rather than parallels—the actual accumulation of local knowledge. This seems reasonable. In the Altona case, the recognition that several key assumptions did not hold in Russia did not automatically translate in alternative solutions to, for example, the distributional problems experienced outside Moscow. In a similar vein, Pedersen and Petersen (2004) found that expatriates’ self-reported understanding of the foreign context in which they operated, over time followed a U-shaped curve rather than a linear increase. Their finding suggests that the disconfirmation and rejection of (perhaps overly simplistic) initial representations of foreign contexts proceeds rather than parallels their actual understanding.

Analogous to how a decrease in the uncertainty experienced towards a foreign market environment may induce firms to increase their degree of foreign involvement (Johanson and Wiedersheim-Paul, 1975, Johanson and Vahlne, 1977), a significant increase in uncertainty as a result of exposed knowledge deficiencies may therefore lead firms to reduce the degree of market commitment and exposure to the foreign market environment to levels which are more in correspondence with the associated risks. The Altona case illustrates that firms may do so by either scaling back the mode

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\(^6\) Indeed, when several key assumptions about the Russian market environment proved incorrect, attempts were made both to sell off Altona’s local subsidiary to a competitor, and to involve a local partner to compensate for the experienced lack of knowledge and experience.
of operation—which in the case of Altona would open up the possibility to resolve the experienced knowledge deficiencies through the involvement of a local partner—or by reducing the firm’s degree of resource commitment.

II: Adaptation of the MNE model

Altona’s organizational response to the disconfirmation of key assumptions in Hungary differed markedly from Altona’s organizational response to the disconfirmation of preconceptions about the foreign market environment in Russia. Whereas in Russia, Altona reacted by considering various forms through which its direct involvement in the Russian media market could be reduced, in Hungary Altona implemented several significant structural and strategic changes. Less emphasis was put on the transfer of home-market knowledge and practices to the Hungarian subsidiary, and the degree of autonomy for the local CEO increased considerably. Similarly, products were no longer modelled directly after German publications but were rather developed locally, which resulted in several new titles. As a result, the Hungarian subsidiary was able to become much more responsive to local consumer preferences and local market considerations.

In order to understand why Altona’s organizational response to the disconfirmation of initial assumptions differed between Hungary and Russia, we need to take into consideration what these initial assumptions and beliefs pertained to. In Russia, most preconceptions were essentially generalizations of characteristics of the market environments Altona had already encountered in most of Central Eastern Europe, and Poland and Hungary in particular. These initial beliefs and assumptions referred for example to local negotiation styles and business cultures, the role of politics in the Russian media industry, and the state of development of local distribution systems.

Instead, the assumption that ‘what had worked well in the German home market can be transferred to the less developed Hungarian media market’ should not be considered as an assumption about the Hungarian market environment in particular, but rather as an assumption concerning the strategic requirements of the media industry in general. What Altona’s failed launch of its leading car magazine underlined was that the success of its international activities was not dependent on the extent to which its superior publishing expertise could be transferred to local markets, but rather on the extent to which formats, layouts, and content could be adapted to local consumer preferences, and on the extent to which production and distribution could be successfully adapted to local conditions and regulations.

In essence, therefore, Altona’s organizational response in Hungary was a response to disconfirmed assumptions about the strategic requirements of the publishing industry. The emphasis on the transfer of know-how and expertise to the local subsidiary, which is characteristic of the international MNE model (Bartlett and Ghoshal, 1988), was replaced by an emphasis on local responsiveness. Similarly,
relatively tight links between headquarters and the local subsidiary were replaced by the decentralization of key decisions and responsibilities, and by a significant degree of local managerial autonomy. This signals a shift towards the multinational MNE model which better reflected the demands posed by the publishing industry.\(^7\) The resulting success was such that ‘the Hungarian model’, as it became known internally, was eventually replicated when Altona established subsidiaries in Poland and Russia.

The interdependence between un-learning and MNE response

In the discussion above, I indicated how acknowledging the role of subjective beliefs and assumptions in key internationalization decisions also draws attention to the organizational responses MNEs employ when key assumptions prove incorrect. The fact that this topic has received little attention in the IB literature is not surprising. In the dominant conceptualization of the internationalization process (Johanson and Vahlne, 1977; 1990), initial preconceptions play a marginal role, as commitment decisions are presumed to be based on a sound understanding of local market conditions (and are even postponed in the case of a lack thereof). On the other hand, studies which focus on adaptation and change of MNEs often do so in the context of changing environmental pressures (e.g. Buckley and Ghauri, 2004, Bartlett and Ghoshal, 1988) rather than in the context of the dynamics of internationalization processes.

The argument developed above is that the organizational response of MNEs when key assumptions prove incorrect is largely contingent on what the disconfirmed assumptions and beliefs in question pertained to. Whereas the disconfirmation of key assumptions about the strategic requirements of the industry is likely to result in an adjustment of the firm’s organizational and strategic capabilities rather than in a change in local market commitment, a change in market commitment—be it in terms of resource allocation or mode of operation—is a more probable response to the increased uncertainty experienced when key assumptions about the nature of the foreign market environment prove incorrect.

The distinction between assumptions which pertain to the strategic requirements of the industry and those which pertain to the foreign market environment to some extent reflects the common distinction in internationalization process theory between (location-bound) local market knowledge, and (non-location-bound) internationalization knowledge (Carlson, 1966; Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977; Eriksson et al., 1997). However, neither the classification of assumptions above, nor the identified MNE responses are meant to be exhaustive. For example, Eriksson et al. (1997) further divide local market knowledge into foreign

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\(^7\) What appears to have facilitated this change in MNE model was that Altona’s international organization was relatively unburdened and unconstrained by administrative heritage.
business knowledge and foreign institutional knowledge, and the appropriate MNE response to exposed knowledge deficiencies may differ accordingly.

For the purpose of this study, however, this initial distinction—between assumptions pertaining to the strategic requirements of the industry and those pertaining to the foreign market environment—suffices. It illustrates that considering subjective beliefs potentially extends the explanatory power of internationalization process theory, not only to high-commitment entry decisions, but also to subsequent decreases in foreign market commitment. While such reductions in market commitment have not received much attention in the literature (Agndal and Chetty, 2007), they are commonplace. For example, Calof and Beamish (1995) found that 23% of the mode changes in their sample involved decreases rather than increases in the degree of market commitment. Although such dynamics have recently drawn the attention of several scholars (e.g. Agndal and Chetty, 2007; Chetty and Agndal, 2007; Pedersen, Petersen, and Benito, 2002) reductions in market commitment are not often explicitly framed within the context of internationalization process theory.

**Table 5.1: The hypothesized interdependence between unlearning and MNE response**

<table>
<thead>
<tr>
<th>Disconfirmed assumptions pertain to:</th>
<th>MNE response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic industry requirements</td>
<td>Adjustment MNE model</td>
</tr>
<tr>
<td>Foreign market environment</td>
<td>Adaptation foreign market commitment</td>
</tr>
</tbody>
</table>

**5.6 Conclusion**

Internationalization process theory continues to be frequently criticized for its inability to explain the internationalization of firms through relatively committed entry modes, such as wholly owned subsidiaries (Andersen, 1993; Axinn and MatthysSENS, 2002; Steen and LiesCH, 2007; Zhou, 2007). In addition, Forsgren (2002) and others have noted that by emphasizing the importance of experiential learning, internationalization process theory has largely disregarded alternative forms of cognitive learning. As a result, the explanatory power of internationalization process theory and the idea of internationalization as an incremental ‘learning through experience’ process have been repeatedly called into question.

In the light of such criticism, the aim of this chapter has first of all been to address a conceptual issue of the internationalization process model in the relation between
knowledge and uncertainty, which has limited the explanatory power of internationalization process theory. Internationalization process theory assumes that the uncertainty experienced by internationalizing firms stems primarily from a lack of knowledge of foreign markets, and from a lack of internationalization knowledge (Johanson and Vahlne, 1977; 1990; Eriksson et al., 1997). Yet in addition to the limited actual knowledge decision makers initially have of foreign markets, subjective beliefs and assumptions make up the knowledge structure of organizational members on which organizational decisions—such as entry and location decisions—are based (Markóczy, 1997). As the case study illustrated, in the absence of actual knowledge, entry and location decisions may therefore instead be based on subjective assumptions and generalizations about the nature of foreign markets. Such prior beliefs appear to have reduced some of the initial uncertainty Altona experienced towards the markets in Central Eastern Europe, which can explain the selection of high-commitment entry modes. It is likely that more realistic assessments can be made about international firm behaviour if we conceptualize internationalization as a process in which the accumulation of experiential knowledge is accompanied by the gradual disconfirmation and unlearning of prior beliefs and assumptions.

In addition to addressing this conceptual issue, I also aimed to draw attention to the question how MNEs respond to the disconfirmation and unlearning of key assumptions and beliefs. Biased and incorrect assumptions and beliefs are not only commonplace in the boardrooms where key internationalization decisions are made (Calof, 1993; Calof and Beamish, 1995); they may also have severe performance implications. For example, in their well-known study on the ‘psychic distance paradox’, O’Grady and Lane (1996) found that incorrect assumptions about the degree of similarity between the United States and Canada accounted for the surprisingly low performance in the US of the Canadian retail firms in their sample. The Altona case illustrated that how MNEs respond to the disconfirmation of such key assumptions may well be dependent on whether these disconfirmed assumptions and unlearned beliefs pertain to characteristics of the foreign market environment, or to the strategic requirements of the industry at large.

In all, incorporating subjective beliefs and assumptions into behavioural models of the internationalization process of firms makes almost intuitive sense, yet the implications are potentially far-reaching. It implies that the considerable commitment of resources to foreign markets early on can—at least on occasion—be explained from a learning perspective by pointing to the uncertainty-reducing effects of prior assumptions and beliefs. This greatly extends the explanatory potential of internationalization process theory beyond strictly incremental internationalization processes. In addition, the conceptualization developed here of internationalization as an experiential learning and unlearning process provides a behavioural explanation for the commonly observed reductions in market commitment, such as mode changes
to less committed modes of operation, which internationalization process theory has been unable to account for (Calof and Beamish, 1995).

The results of this study suggests several lines of further inquiry. For example, while the role of experiential knowledge in the unfolding internationalization process of firms has received due attention (e.g. Erramilli, 1991; Eriksson et al., 1997; 2000), subjective beliefs about foreign contexts have so far been rarely considered. The argument developed here paves the way for a closer examination of behavioural explanations in our understanding of both entry mode decisions—often solely perceived from a transaction cost perspective—and subsequent shifts in the mode of operation. Several other studies provide support for pursuing such lines of inquiry. Calof (1993) and Calof and Beamish (1995) have emphasized the apparent lack of rationality of executives involved in decisions regarding mode change (Calof, 1993), and the subjectivity of perceived market attractiveness (Calof and Beamish, 1995). Pedersen and Petersen (2004) counter-intuitively observed an initial decrease in the extent to which expatriates are familiar with foreign markets, a seemingly paradoxical phenomenon they labelled the ‘entry shock effect’. The questions which such studies and the current study raise, deserve to be explored before we are to discard internationalization process theory as an outdated model of international firm behaviour.