Towards a New Agenda
for the Study of Business Internationalization:

Integrating Markets, Institutions and Politics

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Inaugural Address

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by

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Samenvatting

Richting een Nieuwe Agenda voor de Studie naar International Business: Het integreren van Markten, Instituties en de Politiek - Suzana B. Rodriguez

Het zakenleven wordt steeds internationaler van aard. Tegelijkertijd mengen regeringen zich steeds meer in de gedragingen van bedrijven. Een andere ontwikkeling is het groeiende belang van ontwikkelende economieën, waarvan velen een lange traditie van actieve overheidsbemoeienis kennen. Deze ontwikkelingen samengenomen maken het zeer noodzakelijk om de relatie tussen bedrijven en hun institutionele context te begrijpen. Conventionele theorieën hebben vaak een te gerationaliseerd beeld van deze relaties binnen de internationale handel. Hun apolitieke perspectief mist het feit dat bedrijven politieke relaties met regeringen en instituties in binnen- en buitenland moeten opbouwen om hun internationale activiteiten op te bouwen en te handhaven.

Het doel van deze lezing is om een alternatief perspectief te ontwikkelen betreffende de internationalisering van kleine en grote bedrijven. Dit beschouwt hoe multinationals internationale posities verkrijgen door onderhandelingsmacht uit te oefenen over buitenlandse regeringen. SME's daarentegen zijn vaak te klein en hebben te weinig capaciteiten om direct met buitenlandse regeringen in contact te komen, en zijn vaak gedwongen om internationalisatie te bereiken door te netwerken met andere SME's, plaatselijke gemeenschappen en ondersteunende agentschappen door verschillende vormen van sociale innovatie. De conclusie van deze lezing is dat politieke en sociale perspectieven op innovatie nieuwe wegen openen in het veld van international business.

Abstract

Towards a New Agenda for the Study of Business Internationalization: Integrating Markets, Institutions and Politics - Suzana B. Rodrigues

Business is becoming increasingly international. At the same time, governments are intervening more in the conduct of business. A further development is the growing significance of emerging economies, many of which have a tradition of active government involvement with business. Taken together, these trends make it imperative to understand the relationships between firms and their institutional contexts. Conventional theories adopt an over-rationalized view of these relationships international business. Their apolitical perspective misses the fact that in order to build and maintain international operations, firms need to develop political relations with governments and institutions in home countries and abroad.

The aim of this lecture is to develop an alternative perspective with particular reference to the internationalization of firms, large and small. This considers how multinationals gain international positions through bargaining power with foreign governments. By contrast, SMEs face liabilities in dealing with foreign governments and instead often have to achieve internationalization through networking with other SMEs, with domestic communities and support agencies via various forms of social innovation. The lecture concludes that political and social innovation perspectives open new research avenues in the field of international business.

Content

1. Introduction

Dear Rector Magnificus of the Erasmus University,
Dear Dean of Rotterdam School of Management,
Dear family, friends, colleagues, students and other members of the audience,

The title of my talk today is *Towards a new agenda for the study of business internationalization: integrating markets, institutions and politics*, and I open with two quotes to help set the framework for my talk. The first is from the film The White Countess (2005), in which the character Tod Jackson, played by Ralph Fiennes, observes:

"Without the political dimension, this establishment would be nothing more than a confection".

The second is taken from Boddewyn and Brewer (1994: 125) in an article on international business political behaviour for the *Academy of Management Review*:

"It is precisely the existence of sovereignties (states, governments), which rule distinct political economies, together with the concomitant assertion of governmental controls and of business devices to avoid or exploit them, that distinguishes 'international' from 'domestic' business."

The first asserts that any vision of organizations which neglects politics is amorphous; the process which gives it momentum and coherence is missing. The second reminds us that all international business involves relationships between firms and foreign governments. The central theme of my lecture, therefore, is that in accessing foreign markets and investment opportunities, firms rely on the cooperation of host country governments and institutions, and must therefore manage their relationships, whether directly or indirectly, with them. I make this distinction between direct and indirect relationships because, while some firms (usually large multinationals) have the status to establish direct relationships with foreign governments, others have less power to do so, while others again (mainly the small ones) have none whatsoever. As we shall see, however, even firms with little initial influence can develop their capacity to negotiate with governments in innovative ways.

In short, I would argue that the relations between firms on the one hand, and national/international governments and institutions on the other, should be at the forefront of international business studies. Key in these relations is the extent to which each party can influence the agenda of the other.

2. Setting the international business scene

The context of business operations today is becoming increasingly global, with more and more organizations extending their activities abroad. The recent financial crisis, however, has diminished both public and political confidence in the ability of firms to govern themselves responsibly and of markets to provide adequate sanctions to ensure good corporate governance. The past ten years have thus witnessed increasing government intervention in this regard, in response to a growing demand for accountability.

At the same time, emerging economies have benefited from an increasing share of world GDP, world trade and foreign direct investment (FDI). These economies are characterized by a closer relationship between business and governments than western developed economies tend to exhibit. In China and Russia, for example, the authorities not only negotiate with other governments on behalf of firms, but encourage their large strategic enterprises to enter particular markets. There are precedents for this in previously emerging economies such as Japan and South Korea. In the case of China, its government had until recently maintained a policy of strong incentives to attract inward FDI. It now takes the view that such investment is no longer so vital for the country, which means that multinational corporations (MNCs) operating in China do not occupy such a favourable position as before. In other emerging economies, governments also play a significant role in the internationalization of small firms. In Brazil, for example, the government has gone further than merely promoting exports by stimulating such social innovations as new forms of collective organization among small firms, thus facilitating their effective engagement in international trade.

We can thus identify some major trends:

- Business is becoming increasingly international
- Governments are becoming increasingly interventionist
- Emerging economies are playing an increasing role in international business. In addition, they are establishing a tradition of active government involvement with business.

Taken together, they show why, in order to understand the relationship between firms and governments, we need to adopt a political perspective in addition to the primarily economic ones we have come to rely on.

This naturally raises the question as to whether existing perspectives on international business take proper account of the political dimension. I would argue in this lecture that they do not and that further research is vital, with particular reference to the international evolution of the firm. After reviewing existing perspectives, I will discuss the close involvement of firms with institutions, primarily governmental agencies, and how these relationships contribute to the internationalization process.

3. Conventional theories of internationalization

Theories of the international evolution of the firm comprise several selective strands, in which certain phenomena are highlighted while others are ignored. For around 35 years, the economic and behavioural perspectives have held sway: the former emphasizes, inter alia, transaction costs, resources and firm-specific advantages, while the latter focuses on the mode and timing of internationalization. I would suggest that these conventional approaches do not reveal the nuances of the processes by which firms become international and, in particular, the way in which they negotiate the conditions for operating in foreign countries. In particular, they present an over-rationalistic view of internationalization which underestimates the role played by political strategies by firms in their endeavour to gain markets across borders.

The economic perspective

In its early days, the field of international business studies achieved distinction by drawing attention to the attraction of foreign markets in contrast to the risks imposed by domestic competition and, in some countries, to the limited size of home markets (Hymer 1976, Vernon 1966). The view propounded was that some firms are able to build monopolistic advantage abroad through developing specific products and processes desirable to the markets in their targeted host country. Successful firms may enjoy advantages in terms of comparative costs, establishing production processes that are cheaper to operate than at home, yet superior to those in place in host countries. Buckley and Casson (1976) advanced the economic perspective by analyzing the factors that distinguish MNCs from other firms. They introduced the concept of 'internalization' – the capacity of a firm to secure advantages by bringing under its control operations normally pursued through market transactions. MNCs also have the capacity to expand by creating subsidiaries abroad. Growth in this way safeguards proprietary knowledge, although the firm will only expand as long as the benefits of further internalization exceed the cost.

The eclectic paradigm of Dunning (1980) has the great merit of drawing together elements of previous theories to identify the advantages of ownership, location and internalization (OLI) that motivate internationalization. Thus, ownership advantages (command of resources), the capacity to exploit opportunities abroad through internal organization and the market attractiveness of foreign locations are factors that foster the development of multinational enterprises. Though Dunning (2003) had since recognised that firms from developing countries go abroad as a way to overcome comparative disadvantages, the economic perspective, which is still very influential, has primarily drawn upon the experience of large western enterprises that developed a strong domestic base before internationalization.

The predominant assumption in economic theory has been that internationalization is motivated by the desire to exploit existing ownership advantages. Yet, as noted above, many firms go abroad in the search for assets, in particular those from developing economies. This point has been discussed in an article by Child and Rodrigues (2005) on the internationalization of Chinese firms. MNCs from emerging economies suffer significant disadvantages in comparison with firms in developed countries, e.g. outdated technology, heavy reliance on expatriate workers, limited knowledge of overseas markets and, with a few exceptions, the lack of internationally known brands or trade names (Yip 2000). The "latecomer perspective" (Mathews 2002) is significant in this regard, in pointing out international investment as a means of addressing competitive disadvantage and catching up on expertise.

The economic view is informed by neo-classical thinking, not only in its core assumptions but also its limitations, one of which is that markets are free to operate autonomously, in environments friendly to the strategic intent of the players. This, however, overlooks the fact that firms are in practice subject to all kinds of restrictions, sometimes imposed by other powerful firms but more generally by governments through laws and regulations. Furthermore, this approach presumes rationality on the part of firms, an assumption that does not fully apply in a world that can be constrained by several factors such as public opinion and nationalism, which frequently translate into politics.

It is also noteworthy that the economic perspective plays up the rationality of the firm at the expense of its embeddedness in its wider society. Indeed, by definition it tends to view the subject primarily through an economic rather than a social or political lens. Yet, the way in which business carves out its place in society is historically constituted. Each country brings into play diverse and contradictory 'contextual rationalities', with which multinationals have to negotiate (Dorrenbacher and Geppert 2010).

Developing and transitional economies are typically characterized by active governmental involvement in business, through both ownership and regulation (Peng 2000). This is certainly the case in China. China in the literal sense remains a political economy, despite its development of a market system. Nolan (2001: 193) maintains that large strategic Chinese firms, "without continued state support... were most unlikely to be able to build on their considerable entrepreneurial achievements, and mount a serious challenge to the global giants in their respective sectors". For example, the central authorities have intervened to limit domestic mergers and acquisitions, while fees and other transaction costs are imposed in an arbitrary and often illegal fashion by local authorities (Huang 2003; Meyer and Lu 2004; Nolan 2001). With regard to internationalization, it is significant to note the ways that the national governments of major emerging economies have been actively supporting, and in cases like China actually directing, outward FDI by their strategic firms.

A major weakness of the conventional economic perspective lies in the fact that, for many years, investigation has primarily focused on multinationals. Until recently, small firms have generally been bracketed off from mainstream studies in a separate domain usually referred to as 'international entrepreneurship'. When attention is paid to these firms, however, it becomes evident that, despite being light on resources, they can become international by taking advantage of new marketing and delivery modes offered by modern information and communication technologies (Ojala 2009). For example, while large firms can usually establish social relations directly with host-country organizations, a small firm will rely on mediation by agents and partners instead (Child, Rodrigues and Frynas 2009) and/or joining a cooperative (Hendrikse 2008). Small firms can also construct forms of social organization that build bridges with foreign markets. Although viewing the internationalization of small firms from an entrepreneurial perspective may make sense, segmenting the evidence of large and small firms does not, as it creates a barrier to coherent theory building.

The behavioural perspective

The behavioural perspective is usually seen as distinct from the economic perspective because of its focus on process. In the latter view, choices of location are influenced by perceptions of the difficulties and uncertainties associated with foreign markets (Johanson and Vahlne 1977). These perceptions can be informed by experience, as well as by a lack of information on particular markets. The choices of firms are thus made in a context of bounded rationality, if not outright misconception. The 'psychic distance' of a firm, real or imagined, is seen to influence its choice of foreign markets to enter, with the first investment likely to be in those places perceived to present the lowest level of risk. According to this perspective, firms grow their international operations through gradually enhancing their commitment to their chosen markets and learning to cope with uncertainties.

Through a study with colleagues (Child, Rodrigues and Frynas 2009) I have contributed to the behavioural view of internationalization by investigating British small and medium-sized enterprises (SMEs) entering the Brazilian market. Our thesis is that differences in perception are not as important for actual behaviour (market entry or exit) as the capacity of firms to cope with differences in the foreign market. Firms are more or less likely to access markets perceived as difficult environments according to how skilful they are in coping with factors that they cannot change, such as the legal system, language and cultural constraints. I have also collaborated with a colleague, Linda Hsieh, in advancing conceptions of the environment by investigating perceptions of risk and opportunism by decision makers, together with the kinds of internal adjustment made by a firm in its attempt to maintain collaborative arrangements in foreign countries. This study, primarily based on Linda's work on Taiwanese joint-ventures, led us to examine in greater detail the issue of repairing trust in international alliances (Hsieh, Rodrigues and Child 2010)

Another project to which I contributed concerns the internationalization of Brazilian SMEs in the clothing sector and the issue of 'irrationality' in their attempts to reach foreign markets. This research by Rene Seifert has taught us that, although the resources perspective has the potential to explain why firms internationalize, it cannot explain fully why some firms do not become international (Seifert, Child and Rodrigues 2010). We found that many entrepreneurs prefer to work in their 'comfort zone' and simply do not have the ambition to grow internationally. There is more to bounded rationality than simply limitations of knowledge. Foreign markets may not be part of the entrepreneurial mindset. Though some firms may have specific advantages to explore abroad, they may also identify strongly with the local community, which may be uninterested in foreign expansion. Such firms may suffer from 'insidership', which involves the extent to which their immediate network has developed a sustainable export business and connections abroad. As Johanson and Vahlne (2009) suggest, the motivation of a firm to internationalize emerges in the context of insidership: i.e. the kind of activities and contacts that are developed and valued in networks. 'Outsidership' is viewed as a liability that prevents a firm engaging in local and international networks.

An interesting way in which Johanson and Vahlne (2009) have reformulated their concept of business environments is through the idea of developing opportunities. In their previous work, the Uppsala group to which they belong introduced the notion of 'psychic distance' and by so doing has (1) unpacked the components of the foreign environment, previously understood in a monolithic way; (2) introduced the recognition of psychic distance, thereby implying that foreign environments comprise not only objective but also subjective dimensions, in that entrepreneurs see entry into foreign markets as posing different degrees of difficulty. Relationships are considered important in terms of modifying initial perceptions; they can be a source of new information and also mediate any risks identified in the foreign environment through factors such as trust and commitment. Moreover, if firms through their network are able to develop opportunities in foreign markets, this may mitigate the threats posed by these environments. This reformulated conception of the business environment accords with our findings that the perception of context is closely associated with the capacity of a firm to manage the difficulties that it sees as belonging to that environment.

Some of the limitations of the behavioural approach lie in the underdeveloped view of network dynamics. I would argue that, despite the recent advances in their thinking, Johanson and Vahlne have still not gone deeply enough into the dynamics of insidership and outsidership and have missed the opportunity of enhancing these concepts by drawing from theories of social and political capital. Their perspective on network dynamics treats knowledge creation as unproblematic, in that it overlooks conflicts of interest in relationships. It only considers business-to-business relationships and ignores those between firms and institutions.

Yet it is unrealistic to assume that all theories have equally to meet the criteria of comprehensiveness. These limitations are minor considering the relevance of the contribution of the behavioural approach, which (1) presents a framework that links choices, processes and outcomes; (2) emphasises the role of relational frameworks (networks); and (3) maps key dimensions of the business environment and draws attention to the role played by actors' perceptions of this environment.

4. Integrating markets, institutions and politics to understand the evolution of the international firm

I have argued that firms evolve into international forms not only through the rational processes of choosing appropriate locations but also through 'relational frameworks'. This term was first coined by Scott and Meyer (1983) to designate relations between firms and institutions. I use it to indicate the relationships, both internal and external to the firm, which are relevant to its international evolutionary process. These relationships not only include the firm's central stakeholders but also those actors with which the firm has a direct or indirect interdependence, such as governments and their institutions, competitors and collaborators, and communities in local and host countries. Hadjikhani, Lee and Ghauri (2008) suggest that multinationals are embedded in networks formed by "socio-political actors", whose relationships are interdependent and interest-based and whose dynamics involve trust and legitimacy. These socio-political actors are usually simultaneously engaged in several power frameworks, some of which may be sponsored by large firms and/or serve to connect them in collective action such as lobbying governments. As Barley (2010) also suggests, American corporations have created several organizations with the purpose of coordinating and articulating ideologies and the advocacy of their interests to governments.

The evolution of firms towards internationalization is largely fostered by government policies and intervention, but is also determined by firm initiatives to affect such policies and the business environment (Volberda and Lewin 2003; Van den Bosch, Volberda and de Boer 1999). The possibility of inter-action between firms and their business environment, rather than just re-action by firms, raises the further question of what international 'co-evolution' may signify. A co-evolutionary perspective emphasises the fact that firms are not passive recipients of environmental pressure but can in fact modify this environment and even shape the constitution of markets (Fligstein 2001; Rodrigues and Child 2008a).

My research on the co-evolution of Brazilian telecommunications company Telemig (Rodrigues and Child 2003; Rodrigues and Child 2008a; Rodrigues and Child 2008b) has shown that large firms are able to shape markets through influencing the process of institution formation, including the establishment of their boundaries. This happened at several points in the company's lifecycle, particularly at times of institutional transition and the redistribution of political power through revisions in the national constitution. These turning points created opportunities for the company to influence both its restructuring and that of its industry. During its inception in the early 1970s, Telemig joined with the army and bureaucratic elite to create an 'institutional field' for telecommunications (Scott 1995). Senior executives, a few suppliers – subsidiaries of multinationals already in the country – and bureaucrats came together to define the rules of procurement and even the overall institutional framework for telecommunications. Telemig also influenced the sector through its expertise and reputation, by establishing standards that became the industry benchmark. When Brazil started to open its economy to foreign players, Telemig initiated a movement for privatization. This mobilized actors internal and external to the company, including ministries, senior bureaucrats and MNCs (both established and recent entrants to the market). This interest group was particularly active during Brazil's institutional transition in the mid-1990s. It shaped the regulatory body that today governs the provision of telecommunications services in the country. This study showed that the way in which firms secure niches in markets is largely permeated by power relations of various kinds. These involve social and political processes, such as influencing governments through lobbying, and by interlocking power positions in government and the company. The findings of this research drew my attention back to an issue that motivated the research I undertook in the early days of my career: power and politics within and between organizations (Rodrigues and Hickson 1995; Rodrigues and Collinson 1995)

Attention to co-evolution has been high on the agenda of RSM's Strategy Department for some time, through the work of Volberda and Van den Bosch (Volberda and Lewin 2003; Van den Bosch et al 1999). What I bring to this agenda is the political analysis of how firms evolve into international markets, which necessarily pays attention to the power of firms to influence local and host environments. This also means bringing other actors onto the stage, analyzing their roles in the story of firms and seeking a better understanding of the interplay between them and their wider context. In order to capture this complex 'stage scenario' – actors in their relational frameworks – we need to understand their respective objectives, interests and patterns of influence. Here, both institutional and bargaining power theory have an important contribution to make.

The institutional perspective recognizes that government, through both the legal system and public bureaucracies, has a role in the internationalization of firms, through its connection with both inward and outward FDI as well as trade.

Governments establish constraining regulations and may also offer incentives that bear upon the operations of foreign firms within their domain (Hall and Soskice 2001). Governments may facilitate the internationalization of domestic firms through technical and political assistance, undertaking lobbying activities and inter-government negotiation. A consequence of supportive policies is the significant increase in foreign acquisitions by Russian and Chinese firms in the last decade (WIR 2009). In Russia there has been sometimes seemingly arbitrary government intervention on FDI, in which the state has played a greater role, while in China the sheer amount of inward FDI and its declining strategic relevance has led the government to revise its regulations to protect the indigenous Chinese brands. As stated before, regulatory change is largely a consequence of changes in the relevance of FDI for the development of China. The country no longer requires so much inward investment because it now has huge financial reserves and, in many sectors, technological requirements have been met. On the other hand, the Chinese authorities have come to adopt an increasingly active role in promoting and guiding outward FDI by Chinese firms.

Traditionally, the literature on international business has treated the MNC as an almighty agent that is capable through its "corporate immune system" (Birkinshaw and Ridderstrale 1999) of domesticating foreign territories and actors, primarily owing to the attractiveness of their distinctive capabilities. In conventional analyses, institutions were treated as background features, contributing to the friendliness or risk of the business environment (Henisz and Zelner 2005). Without meaning to undervalue the level of sophistication already achieved by current theory, I would highlight the political dimension of institutions. This means that creating and maintaining an institutional framework which is favourable to inward and outward foreign investors is fundamentally a political decision by government, with resource allocation implications. Such decisions are highly relevant to firms and their appropriation of value abroad. A very recent example is that of British firms threatening to relocate abroad if the government does not introduce more favourable tax conditions. Witt and Lewin (2007) call this institutional movement "escapism". The example provided by these authors is that of a firm engaged in a 'round trip', in order to obtain the advantages of being re-classified as a foreign investment and obtaining preferential treatment at home after relocating its head office elsewhere. As I will show later, firms and governments habitually try to influence each other to modify and reverse decisions in their favour using the most sophisticated weapons (Child, Elbanna and Rodrigues 2010). Firms and governments activate different sources of bargaining power, with greater or less intensity depending on the institutional context. Inconsistent attitudes on the part of governments with regard to policies and sanctions may create instability for firms and zones of friction, with implications for the kind of political strategy that these actors may adopt.

The mutual influence of governments and firms

Relationships between governments and firms are highly complex. Not only do they imply calculating, self-interested intentions by parties but they also occur in a context of power asymmetry, in which one party possesses resources that the other desires. Organization theory has, for some time, wrestled with the question of how much power an organization has vis-à-vis external actors and under what conditions (Hickson et al 1971; Pfeffer and Salancik 1978; Oliver 1991). Bargaining power derives from the ability to withhold resources the other party wants. The way in which firms and governments use bargaining power to influence each other is an issue which has been recognized in organization theory (Pfeffer and Salancik 1978). It posits that having superior resources endows the organization with power to make others, in the external environment, act in a manner they would not otherwise have done. Thus, an organization will be more powerful in relation to external actors if it can mobilize their desired resources, information, technology, finance and relations. To use a well-known simplistic model, power is exercised in a context of dependence, in which A can mediate or withhold resources needed by B. Alternatively, A and B can be interdependent, insofar as each can mediate resources for the other.

As this framework can be used to explain relationships between organizations and governments, it has come to the fore in international business theories when analysing the adaptation and performance of multinationals in host countries (Moon and Lado 2000; Kostova, Roth and Dacin 2008; Bouquet and Birckinshaw 2008; Blumentritt 2008). This raises two issues. The first concerns whether relationships between governments and firms can be cooperative or whether they are primarily conflictive in nature (Moon and Lado 2000; Kostova and Zaheer 1999). The findings to date appear inconclusive, which perhaps is only natural since relationships with host countries are unique. Relationships between actors in this context can be affected by factors of different nature, in which outcomes are defined through the interplay of political forces with economic pressures.

It may be that large firms aiming for a large market share or monopoly power abroad will try to influence host governments as a matter of course, to secure comparative advantage (Frynas, Melhah and Pigman 2006). The argument for conflictive relations comes from the reasoning that firms and governments have different interests and goals (Eden, Lenway and Schuler 2004). While government policy is formally geared to the interests of political constituencies, MNC strategy is more narrowly focused on shareholder interests. Governments typically pursue broader economic, social and political objectives whereas business goals are highly specific: for example, increasing market share and gaining favourable returns from investment in foreign locations. Thus government policy may reflect a nationalistic aim to secure greater benefits from FDI, such as encouraging the development of local industry, technology transfer, employment and a positive balance of payments (Eden et al 2004).

Earlier research has flagged the possibility of power obsolescence. The theory of obsolescent bargaining argues that, over time, multinationals tend to lose their bargaining power with governments. This is due to increasing competition in the foreign market, the improved capacity of governments to negotiate, and the enhancement of indigenous competencies in host countries. Obsolescent power in this case reflects the reduced dependency of governments on multinationals and the increasing fragility of the latter's bargaining power. The theory furthermore asserts the possibility of increasing vulnerability of the MNC, which can culminate in assets expropriation (Vernon 1980; Kobrin 1987).

I would argue that multinationals may become exposed, not so much from declining comparative advantage in their chosen markets, but because of changes in the context of operation within the host countries, for example through intensified competition from local firms. When governments suffer internal pressures they feel obliged to respond, in ways that do not necessarily converge with the competitive interests of foreign companies. The governments of emerging economies in particular face pressure to subsidize local firms; they can also impose specific development orders on multinationals as they enter the country and even retrospectively, affecting firms already established there. In some cases, multinationals lose legitimacy for their claims with governments because the insistence to exploit obsolete technique and products in host countries or because of a policy that insists on outsourcing globally when governments intend to develop local capacity.

There are, however, also many cases in which multinationals develop cooperative relations with host-country governments. This largely depends on the individual skills of local managers and whether they have delegated powers to negotiate and facilitate the exchange of complementary resources. As Frynas et al. (2006) suggest, multinationals can achieve their goals through helping governments attain *their* developmental objectives. This is illustrated by my current research with colleagues (Child, Rodrigues and Tse 2010), which investigates the basis of power of both firms and governments. Drawing on the case study of YICT, now China's largest container port (Tse 2009), we explore how the foreign firm, Hutchinson Port Holdings, and Chinese government agencies have influenced each other's policies and practices in the process of establishing YICT as a foreign owned infrastructure company in China and, in the process, learned to work together. One of the contributions of this study is to understand bargaining power as being *relational*, rather than a property. This signifies that bargaining power shifts according to the matter in hand and as each party begins to understand the agendas and priorities of the other. We demonstrate that reciprocity is a political weapon that although not well understood in the West, is a very important mechanism for trust building in business collaborations in the East.

We also suggest that the framework proposed by French and Raven (1960) is appropriate for understanding the power relations between firms and governments, because it addresses the nature of power as well as its sources. They advance a classification of "the bases of social power", which considers a range of sources from material to symbolic: (1) possession of *material* resources, which provide "the ability to reward"; (2) *coercion*, which can include force and also the withholding of reward; (3) *legitimation*, whereby the exercise of power is regarded as rightful by all parties; (4) *reference*, in which the basis of a person's or unit's power lies in the identification of others with the power-holder; and (5) *expertise*, whereby the expertise held by, or attributed to, a person creates a willingness to accept his or her authority.

Bargaining power in international markets

As suggested, relationships between firms and governments are extremely dynamic, with multiple factors intervening. The outcomes of such relationships are difficult to predict but still consequential, i.e. undesirable and unexpected action by one part may generate a reaction of similar significance by the other. Public policy makers can increase or decrease the power of firms in the marketplace through a number of policies and interventions, such as reducing or increasing barriers to entry and exit, or by imposing environmental and quality standards. Furthermore, governments may alter the size of markets through purchasing decisions that create alternative markets for complementary products (Hillman and Hitt 1999). In societies with strong centralized states like China and Russia, governments can also exert significant sanctions over even large firms through controlling business licenses, introducing tariffs and imposts, and even initiating criminal proceedings against them.

Thus the international business environment is not one of passive acceptance of rules and regulations; it is a volatile arena, encompassing actors whose objectives are highly complex and politically bound. Multinationals do not simply comply. Their activities may impact on issues that are strategic for the state, such as levels of employment and investment. They have bargaining power through the resources they bring to host countries and the threat of their withdrawal. They can form cartels and collude with competitors. Governments and multinationals are thus players in a political theatre, with policy outcomes largely dependent on each other's bargaining power and negotiation skills, including the ability to mobilize support for their respective strategies (Boddewyn, 1988; Boddewyn and Brewer, 1994).

Governments affect multinationals right from the start of their first contact with the host country, by regulating conditions for entry. For example, the Chinese government for a long time formally encouraged inward foreign investment through joint ventures, as a means to encourage technology transfer and learning through partnership, but it has been noted that the strictness of that ruling varies according to an individual firm's relationship with the government (Huang 2003). The Brazilian environment is one of the most difficult to enter, due to lengthy bureaucratic procedures. Though this has been widely acknowledged in the country, nothing has been done to improve the situation. Perhaps institutional difficulties create opportunities for the government to use its negotiating power with foreign entrants besides offering protection to local firms.

Rather than being rational, the decision to support foreign investment is a political one. Such decisions are not taken in a vacuum, but are embedded in political ideologies and government preferences on how economic and social development should take place. Some decisions taken by governments are also likely to be taken in the context of international relations. This is the case of Chinese investment in Latin America. The impressive growth in trade relations between China and Latin America has been largely attributed to complementary interests of firms and governments in both regions. Li (2007) suggests that Latin America is critical for China. The two major objectives of the Chinese government are to obtain raw materials for continuing economic growth and to maintain access to export markets for its manufacturing products. Furthermore, alliances with the countries in the region are crucial in providing safe access to the Panama Canal, an important route for oil supply to China (Li 2007). This seems to be a case in which the firms and governments of both local and host countries possess mutually desirable resources.

As a political action, support for acquisitions of local firms may be subject to protectionist policies and nationalist visions. The brief case below provides an example of a dispute involving Chinese and North American firms and their respective governments: actors with high bargaining power. He and Lyles (2008) suggest that there is some concern by the USA administration regarding Chinese foreign investment and the extent to which the strategies of these firms are imbued with the political goals of the Chinese government. The uneasiness is not so much with the government support some of these firms enjoy, but with the fact that many of the large ones are part- / majority-owned by the government; the more so if strategic sectors are involved. The authors cite the CNOOC bid for Unocal, one of the largest American companies in California. An interesting point was the attraction of rivals, such as Chevron, into the fray. Perhaps as a result of the latter's intensive lobbying, the case was taken up by the Bush administration and Congress. The decision to investigate the national security implications of the Chinese bid resulted in its withdrawal. Another more recent example is the Huawei bid for 3Com in 2008 which was refused on the grounds that the military was the majority owner of the company (Bloomberg Business Week, 2008, February 21). The Huawei bid for Motorola has also been under scrutiny by the American government (Global Times China, 2008 April 6). An interesting point about these cases is that, though companies strive for legitimacy from both internal and external sources, so also do governments.

Another way in which governments can exert bargaining power is by defining the conditions under which foreign companies are granted property rights. In a business relationship, it is unlikely that either the firm or its external parties can use direct coercion to force an event, although not impossible. An example is when the government of Ecuador in 2008 made the decision to seize the operations of the Brazilian multinational, Odebrecht in Ecuador under allegations of failure to meet the terms of a contract on the construction of a hydroelectric plant. Not only had the government sent the army to seize the site, but issued an order for detention of the company's senior management (BBC Brazil.com 2008, October 19). Host governments are able to control the appropriation of value by a firm indirectly, through taxation, adverse regulations or other agreements (Henisz and Zelner 2005), and directly through changing the conditions for property rights.

Expropriation of assets was a major concern of companies and an important theme in the international business literature of the 1970s and 1980s, but has become less of an issue as host-country attitudes towards FDI have softened.

Nevertheless, the threat of government constraints on their core activities is still a major concern for companies investing in less developed or closed regimes. An interesting example is the initiative of the Bolivian government to nationalize the assets of foreign oil and gas companies. The Brazilian oil gas giant Petrobras was forced to reduce its ownership stake and has lost billions in share value since it became Petrobras Bolivia (BBC News, 2006, May 11). A common tactic of Latin American countries such as Bolivia and Venezuela is to appeal to ideology and nationalism to justify revision of policies regarding foreign investment.

Another example is the dispute between the internet search engine and services provider, Google, and the Chinese government. When Google entered China, it was on the understanding that it was better to have censored activity there than none at all. The company has now decided to keep its servers only in Hong Kong, following discovery of an attack on its servers by Chinese hackers. This withdrawal has lost customers and created space for competitors (New York Times, 2010, March 29). Regarding this event, the observation by Microsoft founder Bill Gates that "You've got to decide: do you want to obey the laws of the countries you are in, or not? If not, you may not end up doing business there", reveals the critical need to adapt to the institutional environment of the host country, no matter how the identity of the company is affected. Political skill can also be critical for business performance abroad but making such decisions does not exempt firms from responsibility towards other stakeholders.

These accounts illustrate how governments can exert their legitimate right to change the rules of engagement for foreign businesses. Google was confronted with the quite extraordinary historic power of the communist regime and tradition of government intervention and ownership in business and industry (New York Times, 23 March 2010). As Redding and Witt observe (2007: 43), "the assumption that only a central government power was appropriate was implanted from the beginning and has survived to the present day". Multinationals, by contrast, count on their expertise and capacity to provide unique resources. Ultimately for Petrobras and Google, this was not enough to protect their identity in their host countries. The comment by Bill Gates reveals how politics enters the relationships between firms and governments and suggests, furthermore, that the bargaining power of the latter inheres in the certainty of finding competitors and transferring rights to them.

The easier it is to find a substitute for a firm specific advantage, the greater its vulnerability (Hickson et al 1971), especially within a volatile institutional context. This is further illustrated by my current study of a Brazilian MNC. Despite heavy initial investment in a prospective project in Africa, the exploration rights were in the end given to an influential Chinese competitor. In the battle for a place in foreign markets, firms cannot use any kind of material persuasion, even if they have the resources. Matters of personal ethics and internal institutional constraints intervene. As Kostova and Zaheer (1999) suggest, achieving a balance in internal and external acceptability is a challenge for MNCs. The line between material inducements and forms of undue influence can be blurred and is crossed on a daily basis in some institutional environments.

The exertion of undue influence to obtain preferential government treatment or inside knowledge is not confined to firms from developing economies, as illustrated by a recent case involving BAE. The allegation that the company had secretly paid Prince Bandar of Saudi Arabia more than £1bn in connection with Britain's biggest ever weapons contract led to an investigation by the Serious Fraud Office (SFO) (BBC New 2010, February 5). Other examples abound, such as Siemens and the Chinese prosecution of Rio Tinto employees (New York Times 2010, 29 March). This latter case hit the headlines when certain company executives were sentenced to prison following allegations of stealing state secrets and bribing state officials from the Chinese Iron and Steel Associations when negotiating iron ore prices. The arrests occurred in the context of an attack by the Chinese government on corruption, which also affected Chinese companies, but it has been viewed by pundits as retaliation for the rejection of a bid by Chincalco to invest $19 million in Rio Tinto.

There is some suggestion in the literature that most political business associations develop in countries with weak institutions. The latter have been identified with high levels of corruption and generally low levels of enforcement. Corruption flourishes where a state fails to enforce the rule of law and does not have the mechanisms to control its own bureaucrats or protect property and contract rights (Hellman, Jones, Kaufmann and Schankernan 2000).

My general contention in this lecture is that relationships between governments and firms are still poorly understood, despite the recent burgeoning interest in this topic. I will now set out the current challenges this issue poses to scholars in international business. I would go further and consider, first of all, how governments and institutions together create different environments (or 'systems') for firms in the countries where they operate. Second, I want to explore the implications of those environments for the kind of relational frameworks that embed firms in host countries. International firms participate in these frameworks by socially and politically interacting with local actors.

5. New challenges

Acknowledging the role of institutions is central to the understanding of the international business environment, as has become increasingly evident by the publication of a special issue by the Journal of International Business Studies (JIBS) on this theme *(Journal of International Business Studies, 2008)*.

Through this lecture I have put forward the view that past and current research has approached the environment in a monolithic way, i.e. as 'the market'. We have seen a refinement in scholarly conceptions of the environment, with the idea of psychic distance (at least in its multidimensional form) and later with the adoption of institutional perspectives on the environment. International business theories and work on varieties of capitalism have also advanced the concept of the environment; by looking into the way the institutional system through formal incentives and sanctions empowers particular actors in different countries. Within these perspectives, liberal economies, for example, encourage the actors involved in economic transactions to make decisions based on self-serving interests without much interference from the state (Whitley 2003; Hall and Soskice 2001). Other systems foster relationships between different types of business actor, such as banks and firms in Germany and Japan (Lane and Probert 2009). In countries whose institutions are highly heterogeneous and fail to provide an overarching framework, coordination issues are resolved at a group level (Krug and Hendrichke 2010).

Thus, institutions are relevant to business in respect of the legal frameworks they provide and whether these are sustained by mechanisms of enforcement. Governments are important to institutions, not only in defining their structure and design, but also by making sure that rules are applied. This capacity to enforce matters most when institutions are weak. A society is deemed to have ineffective institutions when the system is incomplete in terms of the comprehensiveness of its regulations, including its consistency in applying these regulations (North 1990). As Williamson (1975) suggest, most institutional systems are incomplete; it is impossible to specify all possible contingencies in contracts, either because of bounded rationality or cost. One implication of this reasoning is that a great many economic exchanges are left to implicit agreements between the parties. This means that behavioural control, instead of happening at the level of formal institutions, depends on informal rules of behaviour, the culture of norms and the values that emerge at the level of organizations or relational frameworks (Scott 1995). Government is important to this equation because it has the authority and power to address institutional failures. In institutionally weak countries that are also politically instable, the equilibrium which could otherwise be found at the level of informal groups may not occur as coalitions fragment.

Governments, however, are not the same as institutions (Peters 2001). The former rise and fall, but the latter may persist through social internalization and enforcement (Berger and Luckmann1966). Governments, moreover, vary in their capacity to fulfil mandates. The stability of governments is important in so far as it lends legitimacy to the institutional system (DiMaggio 1991). In theory, governments as actors can legitimately exercise strategic choice in situations of institutional incompleteness and in the absence of formal mechanisms of enforcement. It can opt for the enforcement of compliance with universalistic rules even in the absence of such rules, or it can leave room for vested interests to decide.

Institutional consistency and government stability

Taking these reflections into account, I want to propose two frameworks for future investigation. The first considers the stability of governments according to their degree of political cohesion and the kind of political relationships that are likely to develop between international firms and host governments. The second considers institutional effectiveness in host countries: the degree of codification and enforcement present in different societies and the kind of relational frameworks in which international firms are likely to interact in these societies.

One definition of political instability is 'a situation where a coalition in governance is constantly replaced'. This is in general viewed as harmful to business, in the sense that it tends to introduce greater uncertainty and unfamiliar risks. Some studies have questioned whether political instability may be worse for business than autocratic governments (Li 2005), because the latter are prone to encourage monopoly power. If a firm makes above normal gains from monopolistic activity, it may be tempted to excise undue influence in order to protect its comparative advantage (Fligstein 2001; Shleifer and Vishny 1997). Government stability is so important to business that the Economist Intelligence Unit undertakes detailed monitoring of political environments across nations. This raises the question of the role national governments play in papering over institutional gaps.

Institutional consistency matters to business insofar as it denotes the separation of the legal system from political interference and an adherence to universalistic and ethical principles. Transparency is essential to the process of implementing rules and norms. The World Bank's annual ranking of the "Ease of Doing Business" in terms of ten indicators applied to 183 countries provides an indirect assessment of institutional maturity as opposed to weakness, insofar as immature institutions usually beset firms with complications and uncertainties, which are often associated with corruption and/or political interference.

This analysis suggests that host countries present different configurations of governmental stability and institutional consistency. With a view to illustrating rather than to providing clear and definite answers to these issues, I propose in Table 1 four contextual configurations presented by different combinations of political and institutional conditions. I have chosen four countries to illustrate these configurations. In Table 1, the top-left quadrant represents a situation where governments are stable and institutions relatively consistent. The USA is a case in point. The USA epitomizes the arm's-length system, in which the initiatives of individual entrepreneurial actors are protected from state intervention. Separation between regulators and the regulated together with a bureaucratic system which is predicated on impersonal and universalistic rules empower individual economic actors (Hofstede 1991). The differentiation of the administration from the political system should ideally guarantee that administrators engage in policy-making without the interference of politicians making particularistic demands (Peters 2001). Yet its fragmented political system offers business actors numerous opportunities to exert influence over politicians and bureaucrats. As Barley (2010) notes, firms influence the government through several interconnected organizations: a network created specifically for this purpose. Lobbying activities occur at several levels. Though there are several ways in which firms can influence the government, the strong democratic values and moral barriers to corruption prevent undue modes of influence from becoming endemic. Though American firms have constructed several types of organization aimed specifically at influencing governments, together with complex systems for lobbying, this activity is highly regulated and relatively transparent in comparison with some European countries.

Table 1: Relational frameworks in different political and institutional conditions

LEVEL OF POLITICAL STABILITY

	High	**Low**
High	**United States** **Economic relations:** primarily market-based encourage individual initiative, with little interference by government **Contracts:** established impersonally and maintained through formal contract within an embedded legal framework **Decision making on business-related policies:** political system clearly separated from the institutional system; separation between regulators and regulated. Still room for political influence through publicly recognized channels.	**China** **Economic relations:** highly embedded in social relations and shaped by political objectives **Contracts:** established through guanxi and maintained through personal trust and commitment **Decision making on business-related policies:** significant role of particularism; channels of influence are personal and largely private
Low	**Belgium** **Economic relations:** primarily market-based but subject to satisfaction of community interests (Flanders vs, Wallonia) **Contracts:** established impersonally and maintained through formal contract. Comparatively well-established bureaucracies **Decision making on business-related policies:** increasingly politicized in the context of conflicting demands of the country's two main communities. Low government power due to national divisions and self-contained communities	**Sub-Saharan Africa** **Economic relations:** deeply embedded in social relations and shaped by personal or factional (often tribal) objectives. **Contracts:** established through informal understandings and maintained through personal pay-offs. Maintenance depends on whether another faction gains control. **Decision making on business-related policies:** highly particularistic; channels of influence are personal and secret. High instability of governments

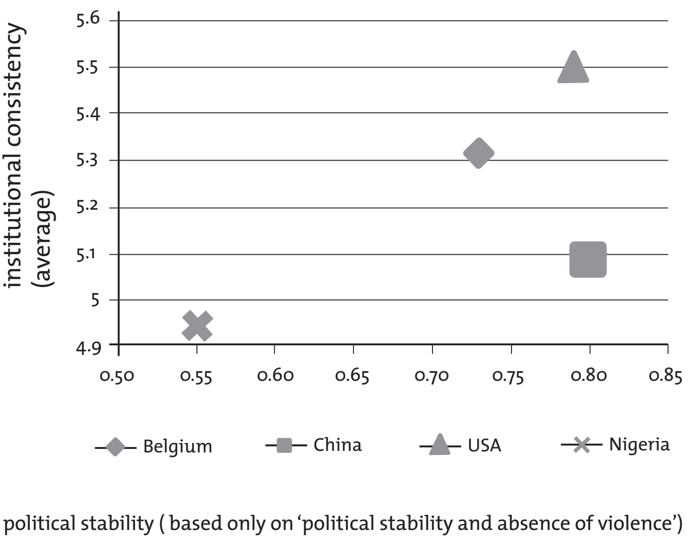
The top-right quadrant represents China. Despite the fears expressed over its future, the Chinese government at the present time is stable, through a pervasive one-party system. Institutions in China are known nevertheless for being arbitrary and personalist. Though many argue that the *guanxi* system in Chinese business is less of a force than before, it persists through its cultural embeddedness. The main problem in China is the ambiguous role exercised by government agencies, which in many cases are also market players. Although the Chinese legal framework appears institutionally incomplete and highly inconsistent, disputes, if they arise, can usually be resolved within relational frameworks. Secure participation in business projects is frequently safeguarded by informal rules that arise from private deals between players, as noted by Krug and Hendrichke (2010). There is also some suggestion that the transference of the assets of State Owned Enterprises to private hands has been defined in the context of networks with state officials and is characterized by a lack of transparency (Fligstein 2001). The lack of consistency in the application of rules leaves ample room for favouritism.

The quadrant below left can be represented by Belgium. This country has an inherent political instability because of tensions between the French-speaking Walloons in the South and the Dutch-speaking Flemish in the north. Belgium has two parallel political systems, with different parties standing for different proposals, each having limited power to implement an overall programme. The professional public bureaucracy is governed on the criteria of merit but the deep political and cultural divisions in society encourages clientage and patronage as mechanisms for maintaining the integrity and power of the two major parties. The introduction of federalism, by establishing a clear demarcation of political powers, resulted in the segmentation of decision-making. It is alleged also to have fostered idiosyncratic links between business and government. Because power is segmented and politicians have very little power beyond their own constituencies, this paradoxically, tends to constrain exercise of undue influence on the authorities (Maiesschalck and Van den Wallen 2009). There is also some speculation that cultural divisions create different attitudes towards relationships between firms and government officials, or whether the French and Dutch parts of the country have distinct tolerance levels concerning corruption (Maiesschalck and Van den Wallen 2009).

Most sub-Saharan African countries would fit well in the quadrant below right. Here we have a situation where both weak governments and weak institutions prevail; they are unable to perform basic functions, even the collection of taxes, which is apparent in the opportunistic or abusive actions of officials (Fligstein 2001). In fragile situations, the state may be lacking in basic legitimacy and/or the capacity to implement programmes that will attract some firms, but may scare off others (Batley 2010). Where the government is immature and unstable and institutions fail to control bureaucrats and property laws, corruption thrives and firms attempt to secure super-normal profits. This encourages situations of 'state capture' (Soreide 2009), in which firms are tempted to shape rules by giving backhanders to public officials. The use of political influence by a firm distorts both the legal framework and the policymaking process for its own individual benefit. A PhD student of mine, who is a senior manager in an African company, states that in order to keep its contract it has to maintain close relations with its military partner, who has the power to terminate the agreement at any time he wants, with no legal sanctions. It is common to find company-owning officials in host countries where both government and institutions are weak, establishing particularistic relations with firms through such holdings.

In an initial test of these ideas, I have taken data from the World Competitiveness Report 2008 and plotted it on the two dimensions of political instability and institutional consistency (Figure 1). This shows Nigeria as having a combination of lower levels of institutional consistency and political stability, while the USA has higher levels of both. China is at the lower end of institutional consistency but shows high governmental stability. Belgium is a country that is difficult to define: it is low in governmental stability but not so low in consistency.

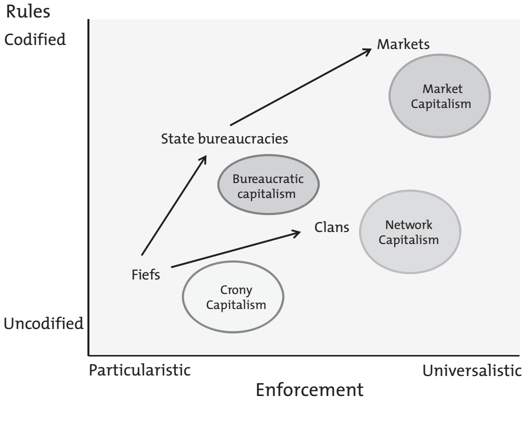
Figure 1: Political Stability vs. Institutional Consistency



Institutional and relational frameworks in different national contexts

A further refinement of this analysis considers the different combinations of institutional codes, the existence of a codified system of rules and the formal mechanisms that ensure their accomplishment and the way in which they may give rise to relational frameworks. Figure 2, extends Boisot and Child's (1996) analyses of different forms of capitalism, by comparing the strength of institutions with a state's capacity to enforce institutional practices across the board. Again, it serves to illustrate the relevance of relationships between firms and governments in different institutional contexts. The top right of the figure represents countries whose business systems are largely dominated by strong, state bureaucracies; evidence as to their economic consequences points in different directions. Evans (1995) points out that educated bureaucracies tend to enhance economic growth. Where state bureaucracies are combined with political monopoly or autocratic regimes, however, high levels of corruption and the misallocation of resources can result (Fligstein 2001; Faccio 2006; Li 2005). Some studies suggest that state bureaucratic regimes are less inclined to protect property rights and tend to introduce nationalist policies, with consequences for asset appropriation or nationalization (Henisz and Zelner 2005). Some recent examples of state bureaucracies can be found in Latin America, namely Bolivia and Venezuela. Though Brazil is now an established democracy and offers a well-developed apparatus of protection in respect of property rights, it is still a country with high barriers to entry, due to its complex array of highly codified regulations. Interpretations of, and adaptation to, bureaucratic constraints imply high transaction costs, and create multiple windows for undue influence (Child, Rodrigues and Frynas 2009).

Figure 2: Institutional and relational frameworks in different national context



Adapted from Boisot and Child 1996, Figure 3, p. 622.

Fiefs represent networks founded on personal relationships and, sometimes, charismatic leaders; they are common in sub-Saharan Africa. Usually they develop in small towns or villages where the leader extracts revenues from personal relationships (Donleavy and Stewart 1995; Bull and Newell 2003). Other types of relational framework common to this part of Africa are the so-called 'para' institutions, which can sometimes regulate the informal economy (Nate 2006). Relational frameworks may emerge on the basis of kinship, religion or tribal values. Divided societies are common mainly in the sub-Saharan states, such as Nigeria. Such societies are characterised by political instability and the lack of a unifying institutional framework. Under these conditions, fiefs, tribes and 'para' institutional organizations take over some state functions through patronage. Such networks establish their own linkages between the state and local communities. Because the state is not accountable to society in a situation of poverty and huge income differentials, patronage becomes the main organizing principle. As it evolves, patronage thus takes over some functions which should be the preserve of the state. Because Nigeria is rich in oil, transactions in these networks are defined by a hierarchy of actors who are able to secure high gains from opportunistic behaviour (Nate 2006). Weak institutional environments tend to yield high returns, usually from leverage, taxation and market power (Faccio 2006). These relational frameworks facilitate the development of private power, i.e. 'state capture', where rule-making depends mostly on the political actors involved (Soreide 2009). This context facilitates the development of 'captor firms': generally larger organizations that use their relationships with politicians to influence laws and regulations via private payments to public officials (Hellman et al. 2000). This kind of situation can, however, impose considerable costs on a firm. Research I am currently undertaking on a Brazilian multinational and its subsidiaries in an African country indicates how often it has to negotiate with actors of different types in order to pursue its exploration activities. The complexity and uncertainty created by having to negotiate with the chiefs and religious leaders of local tribes has obliged the company to re-evaluate and re-programme its activities on the continent. The dynamics of relational frameworks described above tends to be associated with that we may call 'crony capitalism', the widespread personalism, favouritism implied in firm-government relations (Kang 2003).

Clans and network capitalism typify relational frameworks in China. Though China has in recent years moved towards a market system, its institutional framework has not kept pace. It has yet to develop a fully codified bureaucratic order (Boisot, Child and Redding 2010). Institutions are not completely independent of political and business relations, while contracts are still established in a context of interpersonal accommodation and trust. Property rights are varied and complex, giving rise to different forms of capitalism within the same country (Boisot, Child and Redding 2010). They are defined by a context in which the notion of profit-sharing between the business community and local government agents is significant (Krug and Hendrischke 2010). In China it is difficult to distinguish between actors from inside networks and those from outside ones (Boisot and Child 1996). Notions of 'insidership' and 'outsidership' are not as clear cut as Johanson and Vahlne (2009) would suggest. Bureaucrats in China are not only regulators but also active business players. As Krug and Hendrischke (2010) points out, this creates a situation in which rules vary between industries and localities, which in turn gives rise to different types of market design. Boisot et al (2010) distinguish three types of local partner in relational frameworks that may be relevant to foreign firms considering entering, or already established in, China's markets: the state sector, which controls important assets and is highly motivated by nationalistic values; local corporations, which engage in local competition and opportunism: and the private sector, which is defined by a tight network based on entrepreneurship, secrecy and loyalty. The characteristics of relational frameworks in China reflect the so-called 'network capitalism', in which economic transactions are embedded in the context of groups and their relations with other groups, and in which trust and reciprocity play an important part in the dynamic.

The modernization hypothesis assumes that societies tend to change from particularism to universalism and from fiefs to markets, then to bureaucratic states and finally to market forms. Market systems are based on impersonal economic relationships between decentralized and self-regulatory units (Boisot and Child 1996). An important characteristic of the ideal / archetypal market system is that relationships are governed primarily by self-interest. Markets are efficient when supported by universalistic laws and not subjected to political interference or collusion (Hall and Soscike 2001). This is the Anglo-Saxon ideal-type of 'market capitalism'.

This conceptualization highlights the kind of relational frameworks firms are likely to encounter in different institutional international environments. These frameworks can offer several avenues for analyzing the context of internationalization in a much more dynamic way: one that is informed by different markets, institutions and political behaviours of key actors.

Developing these ideas further is a challenge I intend to pursue as Professor of International Business and Organization. What I have just outlined is the terrain for the research questions I would like to see being investigated by the Erasmus Centre for Emerging Economies. Until now I have mainly focused on the case of multinational corporations. However, many small firms have internationalized today, at least through exporting, and you may be wondering whether such firms can influence governments and what kind of relationships they might develop with the host institutions (such as the courts and customs authorities) that impinge on their international activities. While large firms can bring their individual bargaining power to bear on governments and institutions, small ones may be able to exert influence only through association with other firms, through forming cooperatives and partnerships, issues which have significantly been developed at RSM by Barbara Krug, and Rob van Tulder (van Tulder, and Fortanier, 2009).

My plan is to develop a complementary theme that could bridge the streams of research already being undertaken at the School, through investigating the internationalization of the small firm from the perspective of social innovation. Henk Volberda and Frans van de Borsh define social innovation as the transformative capacity of managers. Coming from a co-evolutionary tradition, as they do, I would suggest that social innovation is an important political factor in co-evolution, for it can be mobilized through the relational frameworks constructed by firms across their organizational boundaries.

Social innovation is relevant to small firms in both traditional and high-tech sectors, enabling them to surmount hurdles that might otherwise bar their global market entry and/or integration. When firms take advantage of an environment where both technical and social innovation thrive, such as Silicon Valley, this may in the longer term contribute to the shape the industry and its reputation (Granovetter 1985). The concept of social innovation has been applied in several ways and with reference, inter alia, to firms, networks, social movements and various organizational processes: for example, the capacity of firms to meet social needs. The definition I adopt is close to the one proposed by Mulgan et al (2007) and embodies two elements: (1) new combinations of existing relational frameworks that cut across organizational boundaries; and (2) the development of new social relationships between discrete individuals and/or groups.

In order to illustrate the usefulness of this concept in considering the entry of SMEs into international markets, I would refer to some Brazilian networks that have already drawn the attention of scholars and institutional authorities alike (Cassiolato 2003; Cavalcanti 2006). These are tight local communities organized around product manufacture and production processes. Some of these successful networks have been able to attract different players to the region, such as national and international banks and also migrant firms from other states. These networks, which were initially centered on small towns in isolated areas, now exhibit different configurations in their inter-organizational arrangements, some with a predominantly market orientation involving banks, large domestic firms and multinationals, while others are state-led and include small firms, cooperatives and educational institutions. Data from the Brazilian Department of Industry and Commerce indicate that there are around 800 such networks covering different sectors, which demonstrate varying degrees of local embeddedness and modes of government support.

The first example I have in mind is Projecto Jaiba, located in the state of Minas Gerais (Araujo, Godrim and Souza 2007). It was established in the early 1970s, to improve the irrigation of a semi-arid region in the north of the region, thereby creating the conditions for integrating localized farms and businesses into state economic activities. At its inception, the project received funds from the Inter-American Development Bank, and more recently from the World Bank. Other financial institutions were attracted to the project, including the Japan Bank for International Cooperation (JBIC). As work progressed, large ICT firms also entered the picture, applying their state-of-the-art competences to total quality management (TQM). Within the Jaiba community, cooperatives of small farmers have been created, with a view to protecting their operations and reducing the costs of new technologies, raw materials and marketing. These cooperatives also fulfill additional functions, such as educating their members in relevant aspects of business and trade. Jaiba has several such associations, although it would appear that some are not working well due to difficulties in establishing cooperation and mutual trust among individual farmers. The relevance of this case for international business is the fact that many of these community-based networks are now turning their interests to global markets. Jaiba's exportation of just one fruit, lime, amounts to around two millions Brazilian reals and the estimates suggest that these figures will tend to more the double for 2011.

Research into similar organizational arrangements, such as those in Vale do Sao Francisco, reveals that members of such networks have learned management practices comparable to those of efficient private firms, i.e. aggressive marketing, tight costing and the implementation of production control systems (Cavalcanti and Neiman 2006). As Vale do Sao Francisco network expanded and incorporated actors of various types, such as international supermarkets, trading companies and national and international certification agencies, pressure increased for improved management processes and quality control. Some cooperatives innovated by using personal and formal methods of quality control, such as virtual programmes to monitor and manage production practices. Other strategies of social organization have allowed small firms to integrate into the global market through exporting or other advanced forms of internationalization. Examples include the formation of monitoring groups and encouragement to join relevant national and international associations.

Integration into such heterogeneous networks paves the way for participation in global supply chains, but a consequence of such engagement is the requirement to comply with norms of certification agencies, through strict control of routines. Grading and standardization, however, are new processes for these producers, associations and cooperatives (Cavalcanti 2006). As the community-based networks grow through the incorporation of actors with new forms of ownership and enhance the modes of association between local participants, more efficient forms of organizing are invented, but with two contrasting outcomes: some firms are integrated swiftly into the global market, while others remain excluded. These latter firms can then find themselves becoming increasingly disconnected from their local community. Many small farmers who are unable to meet the requirements of national and international certification agencies may well encounter barriers to continued membership of their cooperatives.

How have the above points clarified the concept of social innovation? The Jaiba case demonstrates that this dynamic can have a positive effect on small firms by creating sustainable business for them through integrating them into global markets. This in turn can trigger a growth cycle for these individual firms. It can, however, also exclude some of them, including late developers. While the criteria of entry into cooperatives and other networks become more closely correlated with those of certification agencies, the networks may ironically become less friendly to locals.

How would research focused on social innovation enrich our understanding of international business? The fact that local communities are, by their very nature, geographically contained facilitates the identification of network boundaries, although such a study would present at least one more challenge: namely, the identification of the various combinations of inter-firm relations, including those with the state and its institutions. A focus on social innovation sheds light on the types of association most likely to bind together actors with complementary skills and foster the integration of small firms into the regional, perhaps even the international, economy. The state and international institutions would appear to have an important role in steering the invisible hand of the market so that social innovation also addresses social needs.

6. Final remarks

This reflection takes us back to the initial objective of my lecture, which was to elaborate on the political dimension of the international evolution of firms and in particular to discuss how firms shape their environment. I came to the conclusion that, while large firms may, through the power they possess, change institutions and shape markets, small firms can only aspire to influence governments, mainly by means of social innovation. Through collective organization these firms are able to build inter-organizational frameworks that may connect them to those in power.

Apart from endowing small firms with the power of mobilization, social innovation provides them with representational legitimacy. Because social innovation constructs an environment that builds upon local resources in order to gain the support of institutions and attract private organizations and governments as partners, this attractiveness provides them with sources of bargaining power. It gives the small a voice. Besides, social innovation is an attraction for important allies who can bring complementarities and strengthen the power of local actors. These are becoming social movements. For example, Fair Trade and other movements associated with 'greens' and 'cleans' add further strength to local collective efforts to integrate into global markets.

Social innovation can also be a mechanism of defense for the small firm against the all-consuming power of large players. I would like to close by stressing the relevance of social innovation in its role as a political force that has the power to transform social and economic environments. If governments of emerging economies are canny, they will take advantage of the opportunities offered by the global market by helping their local firms and other producers to build an environment which welcomes the small and unconnected, thus encouraging an internationalization movement that also meets social needs.

I do hope that the thoughts and reflections I have shared with you today have conveyed the excitement I feel at contributing to the work of the Rotterdam School of Management. The proposed agenda for research that I have outlined will, I hope, create a robust platform on which to build further, diversified studies into the internationalization – and concomitant politicization – of organizations.

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The focus of this lecture is on the relationships between firms and governments and their respective bargaining power in their strategy to access foreign market. It suggests that these relationships can take different forms depending on the configuration taken by host environments, (i.e. combination of government and institutional maturity). Host country environments that are characterized by political stability and institutional maturity offer less opportunities for idiosyncratic relationships between firms and governments, while environments defined by weak institutions and unstable governments present the fertile ground for political interference in business strategies. The lecture concludes by comparing large firms with small and medium-sized firms, which despite having little bargaining power on their own, may be capable to enhance their position in foreign markets through inter-organizational relations with other firms and institutions.

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