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Causes of the difficulties in internationalization

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Abstract
We study the causes of the difficulties faced by firms when they internationalize in search of new markets. We build on the resource-based theory to argue that the difficulties in internationalization can be separated into three main sets based on their relationship to advantage: loss of advantage provided by resources transferred abroad; creation of a disadvantage by resources transferred abroad; and lack of complementary resources required to operate abroad. In each set, we further distinguish difficulties that are specific to a firm from those that are common to a set of firms. We argue that only a few of the resulting types of difficulties of internationalization are exclusive to the cross-border expansion, and propose solutions that address the root cause of each type.
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Introduction

In 1986, Lincoln Electric Company, a US arc-welding firm, started internationalizing aggressively and ran into difficulties despite the firm's distinctive manufacturing capabilities and incentive system, which had made it the leader in its field in the US. When Donald Hastings was appointed CEO he realized that, despite having superior operations and products, the firm faced multiple challenges that limited its ability to succeed abroad: its effective incentive system was often unsuited to foreign operations; managers at headquarters lacked experience in international markets and knowledge in running a complex, dispersed firm; managers of foreign operations convinced managers at headquarters that products made in the US would be rejected in Europe; and Lincoln lacked adequate distribution, relationships in the marketplace, and a sales force that could understand and help customers abroad (Hastings, 1999).

The problems that Lincoln experienced in its internationalization illustrate the numerous difficulties firms face when expanding abroad in search of new markets. These difficulties in internationalization – the problems that a firm encounters as it expands across borders – have traditionally been discussed in aggregate form as the cost of doing business abroad (Hymer, 1976) or the liability of foreignness (Zaheer, 1995). Existing literature on these difficulties has developed into three streams. Studies based in economics label the concept 'the cost of doing business abroad' and discuss its consequences in terms of the additional costs undertaken by the firm operating under uncertainty in foreign markets (Buckley and

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Casson, 1976; Hymer, 1976). Organizational studies label the concept 'the liability of foreignness' and suggest that its consequences are lower performance and increased failure rates (Zaheer, 1995; Zaheer and Mosakowski, 1997). Strategic management analyses highlight the difficulties of managing dispersed operations in multiple countries, rather than the costs of expanding to a specific country as in the other two research streams, and argue that these difficulties lead to lower performance (Tallman and Li, 1996; Hitt *et al*., 1997). These studies have focused mainly on analyzing the *consequences* of difficulties in internationalization;[1] we know less about what *causes* them.

Therefore, in this paper, we answer the question: *What causes the difficulties faced by firms when they internationalize in search of new markets?* We answer this question by building on the resource-based theory (RBT) (Penrose, 1959) to disaggregate the difficulties into their component pieces and identify the root causes of distinct internationalization difficulties. Understanding the root causes of these difficulties is important both for researchers studying internationalization and for managers leading the expansion of their firms. For researchers, we separate the different causes of difficulties into related but theoretically distinct types. We thereby provide a richer understanding of the sources of internationalizing difficulties, which will enable more focused empirical analysis in the future. For managers, our identification of the root causes of existing or potential difficulties will enable them to find better targeted and more effective solutions.

Before proceeding further, we detail the boundary conditions of our conceptual framework. First, we focus on firms with market-seeking motivations for internationalization. Unlike firms that expand in search of resources (natural, efficiency, or strategic) to transfer back to existing operations, market-seeking firms must face new competitors and new customers. As we describe in detail below, this affects both the relative advantage of resources when they are transferred and the need for complementary resources. Of course, resource-seeking firms also face difficulties; in the concluding section of this paper we suggest which parts of our typology may also be relevant to resource-seeking firms. Second, for parsimony, we limit our analysis to the difficulties associated with internationalization to one country. This condition provides a basis from which to differentiate the difficulties associated with international expansion from the difficulties associated with more general expansion across regions, markets and industries. Third, we exclude from our discussion firm advantages. Advantages have been widely analyzed in existing research (see Tallman and Yip, 2001, for a summary), and some authors argue that advantages compensate for difficulties. In our analysis, we choose to find specific solutions to address each difficulty instead of relying on compensating advantages. Fourth, for the purposes of this analysis we assume the firm is able to transfer some resources. In order to internationalize, the firm must be able to transfer some resources across national borders, either indirectly through their embodiment in products (Penrose, 1959), or directly as foreign direct investment (Dunning, 1993).[2] Cross-border transfer of resources is not always simple, since resources may be location-bound (Rugman and Verbeke, 1992; Hu, 1995), have tacit components (Kogut and Zander, 1993), or be subject to legal restrictions (Zaheer, 1995). However, if the firm is completely unable to transfer resources across borders, it would be unable to internationalize.

In the first section of the paper we provide the building blocks for understanding the relationship between resources and difficulties in internationalization. Following arguments from RBT, we develop conceptual categories to distinguish difficulties, and devote a section of the paper to each category. In addition, we discuss how resources the firm possesses prior to its entry in the new country help it avoid specific difficulties; we suggest actions managers can take to overcome each difficulty by targeting its root cause; and we identify which difficulties are exclusive to internationalization and which are not. We conclude the paper with a review of the contributions to existing knowledge, the limitations of the study, and avenues for future research.

Resources and difficulties in internationalization

RBT describes a firm as a bundle of resources that are used to generate products or services that provide value for customers in competition with the offers of other firms (Penrose, 1959). Firm resources are the tangible and intangible assets that are tied semi-permanently to a firm (Wernerfelt, 1984).

RBT offers two important theoretical dimensions by which to classify resources and, therefore, better understand difficulties in internationalization: (1) the relationship between a resource and advantage;

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and (2) the specificity of a resource to the firm. The first dimension ties directly to a core idea of RBT: resources are the basis of the firm's advantage (Barney, 1991; Peteraf, 1993), but not all resources provide an advantage to the firm (Montgomery, 1995; Ray *et al.*, 2004). The second dimension is based on the idea that, while some resources are the firm's alone, other resources are available widely (Penrose, 1959). Whether a resource is advantageous or firm-specific depends on the competitors against which the firm is compared (Tallman, 1992; Amit and Schoemaker, 1993; Brush and Artz, 1999). Since competitors vary across locations, these two dimensions help identify the type of difficulties the firm faces when it internationalizes. We describe each of these dimensions in more detail in the paragraphs below.

Relationship to advantage

In any particular environment, and at any given time, a resource can be advantageous, disadvantageous, or complementary (Montgomery, 1995). First, a resource is considered advantageous or strategic (Amit and Schoemaker, 1993) when it provides the firm with an advantage in comparison with a determined set of competitors, thus supporting the generation of rents (Peteraf, 1993). To sustain advantage, a resource has to be valuable, rare, difficult to imitate, and difficult to substitute (VRIS) (Barney, 1991). Typically, only a few resources in the firm are the basis of the firm's advantage (Ray *et al.*, 2004). Second, a resource is considered disadvantageous when it detracts from the firm's advantage and reduces value creation. Core rigidities (Leonard-Barton, 1992) are an example of disadvantageous resources. Third, a resource is considered complementary when it provides neither advantage nor disadvantage to the firm. Nevertheless, complementary resources are still important since they are necessary for the firm to operate even if they are not the basis of an advantage on their own (Teece, 1986; Montgomery, 1995).

The type of advantage a resource provides is an important dimension to understand when considering difficulties in internationalization because this relationship may change when the firm moves to another country. A resource transferred to another country may unexpectedly lose its ability to provide an advantage to the firm there, or may even become a source of disadvantage (Tallman, 1992; Hu, 1995). In addition, when internationalizing, the firm may suffer from a lack of some complementary resources that limits the effectiveness of its new foreign operation (Eriksson *et al.*, 1997).

Specificity

Resources can also be classified into those that are: (1) specific to a particular firm, or (2) common to a set of firms. Resources are firm-specific when only the focal firm has access to them. These are the resources traditionally discussed in resource-based analyses (e.g., Teece *et al.*, 1997). Resources are common to a set of firms when several companies have access to them. As such, they are inputs in the production process (Penrose, 1959). For example, an efficient transportation system is a common resource available to all firms requiring its use in a location. Although these resources are common to a set of firms, and therefore are unlikely to provide advantage to one firm over the others, they are still important. Access to some common resources can be restricted to firms from or in a particular location (Dunning, 1977; Rugman and Verbeke, 1992). In this case, they become a location advantage that is common across a set of firms in one location in comparison with firms in other locations (Dunning, 1977; Fladmoe-Lindquist and Tallman, 1994).

Just as resources can be classified as firm-specific or common to a set of companies, difficulties can also be classified as firm-specific or common to a set of firms. Some difficulties affect a particular firm, and other difficulties affect all firms operating in a particular location. If difficulties are firm-specific, the firm must look to itself to overcome them. If difficulties are common to a set of firms, then the firm may find allies to help confront the problems.

Difficulties in internationalization

The two dimensions described above (relationship to advantage and specificity) allow us to develop six theoretically distinct categories of difficulties in internationalization. The first dimension – relationship to advantage – generates three categories of difficulties:

(1) *loss of an advantage*, which occurs when resources lose their advantageous nature when transferred to a new country;
(2) *creation of a disadvantage*, which occurs when resources generate a disadvantage when transferred to a new country; and
(3) *lack of the complementary resources*, which occurs when the firms lack complementary resources required to operate in the new country.

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The second dimension – specificity – results in a further separation of each of the above categories into two subgroups based on whether the difficulties are firm-specific or common to a set of firms. Table 1 summarizes the resulting categorization scheme.

In the following sections, we discuss in detail each category of difficulties. In each section we first describe the cause of the difficulty, then discuss how resources the firm possesses prior to its expansion to the new country may reduce that difficulty, and then suggest actions managers can take to surmount that difficulty. We conclude by explaining whether the difficulty is specific to internationalization or not.

Loss of an advantage

The advantage provided by resources is relative to the competitive environment in which the firm operates (Tallman, 1992; Amit and Schoemaker, 1993; Brush and Artz, 1999). The environment in a new country will differ from a firm's home country owing to variations in physical characteristics, such as geography and climate, or in the characteristics of its people and institutions, such as government, businesses, religion, language, wealth, or culture (Bartlett and Ghoshal, 1989; Tallman, 1992; Prahalad and Lieberthal, 1998; Ghemawat, 2001). When competitors and customers differ across countries, a resource that supported a firm's advantage in one country may lose its ability to support that advantage in a new country (Tallman, 1992; Hu, 1995). The loss of advantage may be firm-specific or common to a set of firms.

Firm-specific loss of an advantage: inability to transfer advantage

A firm will face a firm-specific loss of advantage when a resource that is advantageous in existing operations is transferred to a new country, but the advantage provided by that resource does not transfer. We refer to this as *the inability to transfer advantage*. Causal ambiguity (Lippman and Rumelt, 1982) limits the ability of not only competitors, but also the firm, to correctly identify the source of the advantage provided by a resource. Understanding the source of advantage is even more difficult when the firm expands abroad. A resource that is rare (i.e., few competitors have it) in one country may not be rare in another country because of differences in the countries' endowments (Kogut, 1985a). Thus a resource that supported advantage in one country may not support advantage in another. Alternatively, domestic competitors may already have the resource, have imitated it, or have substituted it with another that provides a similar or improved benefit. For example, although the US retailer Wal-Mart achieved an advantage based on a low-cost strategy in the US, this was not a source of advantage in Germany. There, Wal-Mart faced well-established rivals, such as Metro, and hard discounters, such as Aldi and Lidl, that already used a low-cost strategy (*Economist*, 2004; *Business Week*, 2004). Similarly, some local firms in developing countries have managed to compete against large foreign multinational enterprises (MNEs) despite their smaller resource bundle (Wells, 1983; Dawar and Frost, 1999).

Not all firms, of course, face this difficulty when they enter a new country. In many cases the impetus for entry into a new country is precisely the fact that local competitors are weak or non-existent. For example, in contrast to the expansion in Germany, Wal-Mart's expansion in Mexico was very successful because there were few national chains or 'category killers' that could match its low-cost strategy (Neuborne, 1991). In some cases a domestic competitor does not exist: for example, when a firm is an innovator and its advantageous resource is a product in the introduction stage of the product life cycle. In this stage, the innovator has an advantage both in its domestic market and also in foreign countries (Vernon, 1966).

There is little the firm can do to overcome the inability to transfer advantage. The firm can invest in the development of other advantageous resources locally, or allow the subsidiary to create its own strategy and advantage (Bartlett and Ghoshal, 1986; Birkinshaw *et al*., 1998). However, such solutions defeat the purpose of entering a new country to leverage resources already developed, and open the firm up to additional difficulties. Although managers may not be able to overcome the inability to transfer advantage, they can reduce the potential cost by following a gradual internationalization process, for example, by exporting before investing in a wholly owned subsidiary (Johanson and Vahlne, 1977). If the firm has already invested, and still faces an inability to transfer advantage it can de-internationalize and exit to reduce the losses (Benito and Welch, 1997).

The inability to transfer advantage is not exclusive to the firm's internationalization. The advantage provided by an advantageous resource in any location is limited to a period of time (Miller and Shamsie, 1996), and changes in customers' preferences or among competitors within the industry

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Table 1 Causes of the difficulties in internationalization and their solutions

Causes		*Difficulties*	*Solutions*	
Relationship to advantage:	*Specificity:*	*Type:*	*Reduced when:*	*To solve it:*
Loss of an advantage	Specific to a firm	*Inability to transfer advantage:* A resource that was the source of advantage in existing operations loses its advantageous characteristic when transferred to the new country	Competitors in the new country are not up to par, or do not exist, particularly in the introduction stage of an innovation	Develop advantageous resources locally, allowing the subsidiary to create its own strategy and advantage
	Common to a set of firms	*Inability to create value:* A set of firms in an industry do not obtain value from the transferred resources that were a source of advantage in existing operations because their products are not useful in the new country	Not reduced	Avoid entering the new country, or exit it if already entered
Creation of a disadvantage	Specific to a firm	*Disadvantage of transfer:* A resource becomes disadvantageous when transferred to the new country	Firm internationalizes through trade or reduces the value-added activities undertaken abroad	Evaluate the appropriateness of the resources to the new host country, modify the resource transferred if it creates a disadvantage
	Common to a set of firms	*Government-based disadvantage of foreignness:* A set of firms from the same country are discriminated against by the host government because it dislikes their country of origin	Political relations between the home- and host-country governments are good	Obtain support from government, directly by negotiating or lobbying the government; indirectly by linking with prominent local actors who obtain support
		Consumer-based disadvantage of foreignness: A set of firms from the same country are discriminated against by consumers because they dislike their country of origin	Firm or its products lack association with the discriminated country of origin	Avoid connection between firm and country of origin, directly by hiding country of origin, indirectly by using country of origin that is different from true one
Lack of complementary resources	Specific to a firm	*Liability of expansion:* The firm lacks complementary resources needed to operate at the larger scale required by the expansion in the new country	Firm already developed resources to manage the additional scale and complexity before expanding in the new country because it is a large, diversified, or multinational firm	Develop management and information systems in existing operations; alter the organizational structure
		Liability of newness: The firm lacks complementary resources required to compete in the industry of the new country	Firm operates in a global industry with similar competitors and customers across different countries	Invest to develop the complementary resource needed to compete in the industry of the new country; purchase the resource; access the resource of a local firm through an acquisition or alliance
		Liability of foreignness: The firm lacks complementary resources required to operate in the institutional environment of the new country	Firm has operations in countries with institutional environments similar to the new country	Invest to develop the complementary resource needed to operate in the new institutional environment; purchase the resource; access the resource of a local firm through an alliance
	Common to a set of firms	*Liability of infrastructure:* A set of firms do not obtain value from transferred resources because customers in the new country lack complementary assets to use their products	Products are simple to use or standalone	Provide customers with the complementary tangible or intangible asset necessary to use the product

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can lead to the obsolescence of the advantage provided by a resource (Teece *et al*., 1997). The likelihood of facing this difficulty, however, is greater when crossing national borders, since managers are unlikely to have as much knowledge about the new market as they do about their home market, and therefore misjudge the transfer of advantage abroad.

These ideas can be summarized in the following proposition:

> **Proposition 1a**: A firm entering a country in search of new markets is more likely to face difficulties when the advantageous nature of resources disappears upon transfer to a new country – specifically, when a resource is not rare in the new country or when local competitors have imitated or substituted the resource.

Non-firm-specific loss of an advantage: inability to create value

In some extreme cases the environment in the new country is so different that an entire set of companies, or all the companies in an industry, are unable to transfer their advantage to the new country. We refer to this as *the inability to create value*. In such cases the industry is not viable in the new country, as customers cannot use, do not need, or do not pay for the products or services of the firms. There are several causes of this. In countries where labor costs are low, products or services that are specifically designed to provide labor savings may not create value. For example, remote security monitoring is less necessary when guards are inexpensive. Cultural norms may also preclude the viability of certain products or services. For example, firms producing alcoholic beverages are limited in their ability to create value in countries where alcohol consumption is banned by religious precept. Geographic characteristics may also determine the viability of an industry. For example, firms producing mining equipment will not have a market in countries without valuable minerals. Institutional characteristics can also limit the ability of firms in an industry to appropriate rents. For example, in countries with weak protection of property rights, software or music firms are unable to benefit from their innovations because customers copy programs or songs and piracy is not prosecuted. These differences across countries affect all firms in their respective industries, so it is not a firm-specific difficulty. It is unlikely that firms would choose to enter a country when such conditions exist, but there are many cases of firms doing inadequate up-front planning and overestimating the value they can potentially create in a new country (Ricks, 2000).

Managers can avoid the inability to create value by collectively working to alter the environment and make their industry viable, for example lobbying the government to enforce property rights or changing cultural norms to make the product acceptable to customers.

The inability to create value is not necessarily exclusive to internationalization. Again, in an extreme case, a firm could theoretically diversify into an unrelated industry that is not viable in its home country.

In sum, in some instances a whole industry is not viable in a foreign country and, as a result, a set of firms will not be able to transfer their advantages there. Hence we argue that:

> **Proposition 1b**: A set of firms entering a country in search of new markets are more likely to face difficulties when the advantageous nature of resources disappears when transferred to a new country because the industry is not viable – specifically, where resources of a set of firms that supported the creation of value in existing locations do not create value for clients in the new country because clients there cannot use, do not need, or do not pay for the products generated with the resources.

Creation of a disadvantage

In the previous section, resources simply ceased providing an advantage in the new country. In this section, we discuss resources that actually become liabilities, or disadvantageous, when transferred. In some cases this affects one specific firm only, and in other cases it affects a set of firms.

Firm-specific creation of a disadvantage: disadvantage of transfer

Some of the firm resources transferred to the new country may create a disadvantage in relationship to other firms, resulting in the destruction of value created by other resources. We refer to this as the *disadvantage of transfer*. The firm develops resources adapted to the characteristics of the environment in which it operates (Penrose, 1959; Porter, 1985, 1990). This resource accumulation is path-dependent, resulting in firms with distinct resource bundles (Dierickx and Cool, 1989). Such resources and the knowledge associated with their use are

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then codified into routines to facilitate the retrieval and replication of resources over time and across locations (Nelson and Winter, 1982; Kogut and Zander, 1993; Winter and Szulanski, 2001). As the company transfers them to another country, however, routines that were embedded in technical and managerial systems and supported by values and norms prevailing in the original context may be incompatible with the characteristics of new host-country environment, and create a disadvantage. For example, Lincoln Electric had a unique and highly successful incentive system based on piecework and bonuses, which worked very well in the US. However, this incentive system engendered conflicts and discontent among the employees of its European operations because the prevailing culture of labor was hostile to such systems (Hastings, 1999). A resource that in the US created an advantage against its competitors became a source of disadvantage in Europe.

Some firms may be less susceptible to the disadvantage of transfer. The fewer the resources transferred to a new country, the lower the problems generated if the resource is disadvantageous in the new country. Thus firms adopting a gradual internationalization process (Johanson and Vahlne, 1977) will be more likely to avoid unexpected costs associated with the disadvantage of transfer. A firm that internationalizes by exporting, transferring its resources indirectly through their embodiment in products created with those resources (Penrose, 1959; Tallman, 1992), reduces the resources transferred and therefore the costs incurred if resources become disadvantageous abroad.

Managers can actively overcome this difficulty by being selective in choosing which resources are appropriate in the new host country, and which require modification (Prahalad and Doz, 1987; Bartlett and Ghoshal, 1989). However, the literature on causal ambiguity suggests that this assessment is not always simple (Lippman and Rumelt, 1982; Szulanski, 1996). Managers who are able to move from blind to conscious replication through deliberate learning (Zollo and Winter, 2002) may more successfully judge which resources are inappropriate in the new host country. Alternatively, the firm can transfer the resource at an intermediate stage, where the resource is not as fully embedded within the original context, and the accumulation trajectory can occur within the new context.

Even firms that are not internationalizing can face a disadvantage of transfer – resources that were a source of advantage can also become a source of disadvantage in the same country, For example, a firm may diversify into an industry where the resources transferred create a disadvantage. Alternatively, conditions can change such that what used to be an advantage becomes a disadvantage. For example, core capabilities can become core rigidities even in a strictly domestic context, as Leonard-Barton (1992) describes. Nevertheless, internationalizing firms are far more susceptible to this type of difficulty owing to their unfamiliarity with the new host country's market.

We summarize these arguments in the following proposition:

> **Proposition 2a**: A firm entering a country in search of new markets is more likely to face difficulties when some of its resources become disadvantageous when transferred to a new country – specifically, when a firm-specific resource developed in one context conflicts with a characteristic of the new context.

Non-firm-specific creation of a disadvantage: disadvantage of foreignness

Disadvantages may result from causes that affect more than one firm, and are therefore not firm-specific. When conducting business in other countries, the government or consumers in a country may discriminate against a certain nationality. Nationality is something that is common to multiple firms, and therefore non-firm-specific. When a firm's nationality puts it at a disadvantage relative to domestic firms, we call it *the disadvantage of foreignness*. A resource in the firms' bundle, their country of origin, becomes a source of disadvantage in the new country when it was not necessarily so in other operations. Unlike the other difficulties discussed thus far (the inability to transfer advantage, the inability to transfer value, and the disadvantage of transfer), the disadvantage of foreignness is specific to internationalization because it is linked to national origin, and a firm faces it when it crosses national boundaries.

The disadvantage of foreignness can occur when either the government or consumers discriminate against the firm's country of origin. These two groups differ in terms of awareness of the true country of origin of the company and in the impact on the firm. The government is in a position to know the country of origin of the firm and limit or block a firm's operations. In contrast, consumers in the host country are less likely to be aware of the

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true country of origin, and may react more to the perceived country of origin than to the real one. Consumers cannot block the operations of the firm, but they can negatively affect the sale of products. Hence we discuss government-based and consumer-based disadvantage of foreignness separately.

Government-based disadvantage of foreignness

Some host-country governments discriminate against foreign firms in general, or firms from one country in particular, because these companies pose a threat to their sovereignty (Hymer, 1976; Stopford and Strange, 1992; Kobrin, 2001). To reduce such threat, the government in the host country establishes limitations to the activities of foreign firms there (Buckley and Casson, 1976; Stopford and Strange, 1992; Kobrin, 2001; Spar, 2001), increasing the risk of operating in the host country (Kobrin, 1979; Fitzpatrick, 1983). The local government can go to the extreme of reneging on previous contracts or nationalizing investments, particularly when there are weak protections against this (Henisz and Williamson, 1999). Discrimination can also occur in countries considered to have low political risk. For example, in early 2006 the US Congress interfered in the acquisition by Dubai Ports World of the British company P&O, which managed terminals in six US ports. Alternatively, governments may discriminate against foreign firms indirectly by making only domestic companies eligible for benefits, such as subsidies or preferential purchase contracts (Zaheer, 1995; Mezias, 2002b). In other cases, discrimination can be subtle. In the late 1990s, for example, Coca-Cola in Brazil claimed that local soft drink manufacturers were able to sustain much lower prices because local firms were engaging in tax evasion that was overlooked by the government (Gertner *et al*., 2005). The disadvantage of foreignness can lead to lower revenues when foreign firms are constrained in their operations, to higher costs of operation when foreign firms are excluded from subsidies, and to outright losses when foreign firms have investments expropriated.

This risk of facing government-based disadvantage is very low when political relations between the home- and host-country governments are good, since the treatment of foreign firms by the host country becomes intermingled with the relationships between the home- and host-country governments (Stopford and Strange, 1992). Unlike other difficulties that tend to decrease over time and with experience, however, the disadvantage of foreignness can increase, sometimes quite abruptly, as the political environment changes; conversely, it can also cease rapidly. For example, as a result of the lack of support by the French, German, and Russian governments for the US-led war in Iraq, the US government excluded companies from those countries from bidding for reconstruction contracts (*Economist*, 2003). The ban was later lifted as the countries pardoned part of Iraq's foreign debt. Additionally, a government disadvantage of foreignness may not be consistently applied. For example, in late 2004 the US Congress allowed the acquisition of the personal computer division of the US firm IBM by the state-controlled Chinese firm Lenovo, but in 2005 the US Congress blocked the acquisition of the US oil firm Unocal by the also state-owned Chinese firm CNOOC.

Managers of a firm that face government-based discrimination can attempt to overcome it directly, by negotiating with the government, highlighting the benefits the firm brings to the country, while emphasizing its flexibility in moving to another country if the unfavorable treatment by the government continues (Kogut, 1985b; Stopford and Strange, 1992). Coca-Cola lobbied tax agencies and lawmakers in Brazil to make a case for stronger government control over local beverage producers, for example (Gertner *et al*., 2005). Alternatively, managers can overcome this disadvantage indirectly by establishing links with prominent local actors who can obtain the support of the government (Luo *et al*., 2002).

Consumer-based disadvantage of foreignness

Consumers, acting independently of their government, may discriminate against the foreignness or the specific country of origin of the firm. Consumers may dislike the country of origin for nationalistic reasons, or may have a negative perception of the quality of products generated in the foreign country. As a result, firms experience reduced revenues independent of product or service quality (Bilkey and Nes, 1982; Peterson and Jolibert, 1995). For example, Sarik Tara, chairman of Enka Holding, Turkey's biggest construction company, indicated that its company had to look for contracts in Russia rather than in France because in France 'I am stamped "Made in Turkey", not "Made in Germany"' (Munir, 2002: 2). Like government-based discrimination, this difficulty can vary with current events. For example, when France opposed the US invasion of Iraq, some consumers in the US boycotted French wine, independently of

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the brand (Debord, 2003). Although this form of the disadvantage of foreignness tends, primarily, to affect the marketing of products, it may take other forms such as labor lawsuits, which target foreign firms more often than local ones (Mezias, 2002a). The disadvantage of foreignness can lead to lower revenues when firms sell less than they would otherwise, or to higher costs in the case of lawsuits.

A firm reduces its risk of encountering consumer-based disadvantage of foreignness when it does not have a country of origin clearly associated with it or with its products. In contrast to the government, consumers do not always know the true country of origin of products, but rather act on their perceptions. Thus, when the product has multiple countries of origin for its parts, assembly, and design, there is less association with a single country of origin (Chao, 2001). Alternatively, when the firm produces for original equipment manufacturers (OEMs) who, in turn, stamp the product with the OEM's brand name and the image of their own country of origin, there is a reduced association with the actual country of origin.

Managers of firms that face the consumer-based disadvantage of foreignness can overcome it by actively avoiding the connection between the firm and its country of origin. They can do this directly by not indicating where the firm is headquartered or where the product is manufactured, or by using a regional label, such as 'Made in the European Union', to mask the country of origin (Schweiger *et al*., 1995). Managers can go even further and disguise the country of origin under a local image by using a local-sounding brand, acquiring a local brand, or allying with a local partner who provides the interface with local customers.

In sum, we argue that:

Proposition 2b: A set of firms entering a country in search of new markets are more likely to face difficulties when a common resource becomes disadvantageous when transferred to a new country – specifically, when the government or consumers in the new country have an aversion to the specific country of origin or to the foreign nature of firms.

Lack of complementary resources

A company may also face difficulties because of a lack of complementary resources. Owing to differences across countries, some resources cannot be transferred to the new country (Rugman and Verbeke, 1992; Hu, 1995). Alternatively, additional resources may be necessary in the new country that are not necessary in the home country. The lack of such resources can negatively affect the operations in the new country *vis-à-vis* local competitors, since the internationalizing firm will need to incur expenses that local competitors do not. To obtain these complementary resources, the firm may have to purchase, or establish an alliance with, a domestic firm (Anand and Delios, 1997, 2002).

In resource-based thinking, complementary resources (those that are necessary to operate but do not provide advantage) do not receive the same attention as advantageous resources (those that are valuable, rare, difficult to imitate, and difficult to substitute). Nonetheless, complementary resources are recognized to be critical to the functioning of the firm (Montgomery, 1995). They are especially noteworthy in the context of internationalization, where determining which resources are necessary may not be obvious.

We distinguish two types of difficulties that arise from the lack of complementary resources. The first type is encountered by a firm when it needs additional resources to complement its existing resource bundle in order to operate at a larger scale, under different industry conditions, and within a context of different institutions. The second type of difficulty is common to a set of foreign firms in an industry entering the new country where the potential customers, not the firms, lack the complementary resources needed to use the firms' products.

Firm-specific lack of complementary resources: liabilities of expansion, newness and foreignness

Among the firm-specific difficulties that arise from the lack of complementary resources we separate three types based on the nature of the complementary resources the firm lacks:

(1) the liability of expansion, or the lack of complementary resources needed to operate at a larger scale;
(2) the liability of newness or the lack of complementary resources needed to compete in a new competitive environment; and
(3) the liability of foreignness[3] or the lack of complementary resources needed to operate in a new institutional environment.

These three types correspond to the types of experiential knowledge required for successful internationalization proposed by Eriksson *et al*. (1997): internationalization knowledge about how

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to be an international firm; business knowledge about the new country's competitive environment; and institutional knowledge of the new country's institutional environment. We build on their conceptualization to include the lack of *tangible* complementary resources.

Liability of expansion

Internationalization is often accompanied by an increase in the scale of a firm's activities. Adding new operations, especially when they are geographically distant, requires the firm to deal with additional transportation, communication, and coordination (Vernon, 1977), and complexity (Tallman and Li, 1996; Hitt *et al*., 1997). To manage this, the firm needs spare resource capacity. If it does not have this capacity, the firm may have to stretch its existing resources so thinly that they become ineffective (Penrose, 1959). We call this the *liability of expansion*. This may affect the overall operations, not just those in the new location. For example, when Lincoln Electric rapidly internationalized in the late 1980s, it had few managers and no members of the board with international experience, and the negative impact of this extended to the entire company (Hastings, 1999).

A firm has a reduced risk of facing the liability of expansion when it has already developed experience and resources from operating on a large scale and coordinating dispersed operations before entering the new country. Firms that are already MNEs have usually developed the necessary resources to manage operations across many countries. Such firms can more easily manage the expansion into a new country. Additionally, a firm that is not yet international, but is product-diversified or manages businesses across several geographic locations in its domestic market, will also be less likely to suffer this difficulty. It will already have many of the complementary resources needed to operate on a larger scale, such as an efficient structure, better governance, and enhanced managerial capabilities (Hitt *et al*., 1997: 776).

Managers of a firm suffering from a liability of expansion can overcome it through changes to information systems (Hagstrom, 1991), human resources (Hedlund, 1986), organizational culture and managerial expertise (Bartlett and Ghoshal, 1989) or structure (Chandler, 1962; Stopford and Wells, 1972; Galbraith, 2000). These changes positively affect not only the current foreign expansion, but also future expansion.

The liability of expansion is not exclusive to internationalization. A firm faces similar difficulties when it grows from being a local competitor to being a regional or national competitor (Welch and Wiedersheim-Paul, 1980), or when it diversifies into multiple industries (e.g., Hoskisson and Hitt, 1990). The coordination costs involved with internationalization, however, are usually higher than in a domestic context (Hitt *et al*., 1997; Vernon, 1977).

Liability of newness

A firm's existing competitive environment induces it to develop certain strategies and resources to compete against other firms within a particular industry structure (Porter, 1985). When the firm moves to another country, the competitive environment often differs, requiring some additional resources that the firm does not have there, either because it cannot transfer them across countries or because it has not developed them. For example, Lincoln Electric found that, in its international expansion in Europe, it lacked several resources, such as proper distribution, relationships in the marketplace, and people who could understand and help customers, which limited its success (Hastings, 1999). We call this the *liability of newness*.

Some internationalizing firms face a reduced liability of newness owing to similarities in industry conditions across countries. In so-called 'global' industries the firm faces similar competitors, customers and suppliers in multiple countries (Levitt, 1983; Prahalad and Doz, 1987). As a result, the same set of resources developed to meet the needs in existing markets helps the firm meet the needs in a new country.

Managers can overcome the liability of newness by actively developing or acquiring the complementary resource needed to compete in the new country. The firm can invest to internally develop the resource it needs: for example, if it needs a sales force, it can hire, train, and deploy one. Alternatively, the firm may acquire the resource in the host market: for example, if it lacks an office building, it can buy one. Acquiring a complementary resource in the market may be quicker than internally developing it. If there is no market for the individual resource, the firm may consider obtaining it by acquiring or allying with a domestic firm that has the resource (Anand and Delios, 1997, 2002). In this case the firm needs to take into account the cost of acquiring additional resources it does not need and the challenge of integrating

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them within the firm's operations (Hennart and Park, 1993; Hennart and Reddy, 1997), later disposing of excess resources that it did not desire (Capron *et al*., 1998).

The liability of newness is also not exclusive to the internationalization of the firm. New entrants even in domestic situations lack some complementary resources to compete in a new industry environment – resources that established competitors already have – and therefore suffer disadvantages relative to established firms (Lieberman, 1989). Although a domestic situation may also require new complementary resources, in an international situation the need for new complementary resources may not be as obvious or understandable, and the resources may not be as simple to obtain.

Liability of foreignness

The institutional environment, the set of norms and rules that constrain human behavior, such as culture, language, religion, and the political, legal, and economic systems (North, 1990), affects all firms operating in the country. A firm's home-country institutional environment induces it to develop certain resources to operate effectively in that environment and interact with other social actors (Tallman, 1992; Oliver, 1997). However, when the firm moves into a new country with a different institutional environment, it may lack the complementary resources, such as understanding, relationships, and social capital needed for dealing with other entities and prevailing rules of behavior (Calhoun, 2002; Zaheer, 2002). We call this the *liability of foreignness*. This lack of complementary resources needed for understanding the new institutions creates difficulties. For example, when Jollibee, a fast food company from the Philippines, expanded to Hong Kong it had trouble interacting with clients. Jollibee lacked the complementary resources in the form of local Chinese staff who could understand Cantonese. Chinese customers needed to speak English to Filipino and Nepalese staff, and this kept some customers away (Bartlett and O'Connell, 1998).

A firm may suffer little or no liability of foreignness when its existing operations, either in the home country or in other countries, are in institutional environments that are similar to the one in the new host country (Johanson and Wiedersheim-Paul, 1975; Barkema *et al*., 1996; Barkema and Vermeulen, 1998). In this case, the firm can use the resources developed in existing operations to deal with institutions in the new country.

Managers can overcome the liability of foreignness by developing the complementary resources internally. Overcoming the liability of foreignness is more challenging than solving other liabilities because it involves the transformation of deep-seated assumptions about the appropriate rules of behavior (Prahalad and Bettis, 1986; Prahalad and Lieberthal, 1998), the development of tacit knowledge of how to operate in the new institutional environment (Johanson and Wiedersheim-Paul, 1975; Eriksson *et al*., 1997), and the creation of new information networks (Zaheer, 2002). The firm can do so through internal learning-by-doing, gradually increasing the commitment to the new country (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977; Petersen and Pedersen, 2002). Although the firm can use external methods such as acquisitions and alliance, these are less adequate in dealing with the tacit dimensions of the institutional environment (Johanson and Vahlne, 1977, 1990).

Similar to the disadvantage of foreignness, the liability of foreignness affects only firms that internationalize, since it originates in the differences in social and institutional contexts that exist across countries. A firm that expands nationally in countries with several religious, language, and ethnic groups, such as India or China, faces aspects of this difficulty, but these countries still have common legal, political and economic systems.

This discussion of the three liabilities that the firm suffers when it lacks necessary resources to successfully operate in a new host country can be summarized in this proposition:

> **Proposition 3a**: A firm entering a country in search of new markets is more likely to face difficulties when it lacks complementary resources required to (1) manage an increase in scale, (2) compete against established local players, or (3) operate in the institutional context of the new host country.

Non-firm-specific lack of complementary resources: liability of infrastructure

Occasionally, difficulties arise not from the firm's lack of complementary resources, but from the host country customers' lack of complementary resources needed to use the firm's products or services. We refer to this as the *liability of infrastructure*. This difficulty creates problems for all firms seeking to market a similar product or service. For example, when Star TV moved to launch

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satellite television in Asia, it found that both a retail network for satellite dishes, and a way to track viewers (which is critical to attract advertisers), simply did not exist in many of the countries it was targeting (Laurence *et al*., 1994). Any satellite firm would have faced such difficulty. The complementary resources necessary may be tangible (e.g., the availability of refrigeration for products that need to be kept cold), or intangible (e.g., knowledge about how to use an innovative product). Firms that attempt to internationalize to countries where customers lack necessary complementary resources are unable to market their goods as they are, and therefore face difficulties.

A firm will be less likely to face the liability of infrastructure if its products are standalone or simple to use. When products are standalone, even if they are complex and have several high-tech subsystems (Dyerson and Pilkington, 2000), customers can use the products without additional investments in complementary assets. For example, hand-crank-powered radios are appropriate in countries where the electric supply is sporadic and it is difficult to find batteries. When products are simple to use, customers utilize them without the need to invest in developing the complementary knowledge. In both cases, early investment in design reduces the likelihood of facing the liability of infrastructure later.

Managers can overcome this difficulty by providing customers with the tangible complementary assets needed to use the firm's products, or the knowledge necessary to use the products. For example, the cereal firm Kellogg developed a marketing campaign to train Indian consumers to eat cereals for breakfast, a new eating habit for many of them (Prahalad and Lieberthal, 1998). Providing customers with complementary assets is expensive, however, and does not ensure the firm will reap the benefits because competitors can free-ride (Heil *et al*., 1991). Indeed, Kellogg found that local Indian competitors benefited from its consumer education efforts and introduced their own cereals with local flavors. To avoid this, firms can use bundling strategies, providing complementary assets that are compatible only with the firm's offer (Burstein, 1984; Tirole, 1988). Alternatively, the firm can redesign the product to the conditions of the existing infrastructure of the new country. For example, a Western frozen dessert firm redesigned its products to withstand higher temperatures for the Indian market because in most retail outlets refrigerators were not cold enough (Prahalad and Lieberthal, 1998).

The liability of infrastructure is not exclusive to the firm's internationalization. Firms may face similar problems when they move across market segments in their home country. Alternatively, firms may face this difficulty when they introduce an innovative product and customers lack the knowledge to use it or fully understand its benefits. However, the problems caused by the liability of infrastructure are much more likely to appear in situations where firms are operating in countries with large differences in terms of infrastructure development, for example between developed and emerging markets, which occurs in an international situation (Khanna *et al*., 2005).

We summarize these arguments in the following proposition:

> **Proposition 3b**: A set of firms entering a country in search of new markets are more likely to face difficulties when the customers in the new country lack complementary resources needed to use the firms' products or services.

Conclusions

In this paper we analyzed the causes of the difficulties associated with seeking new markets across national borders. Using the theoretical lens of RBT, we classified these difficulties into six types by their relationship to advantage and by their specificity. We discussed how each type requires different solutions, and argued that only a few of them are exclusive to the internationalization of the firm.

The resulting classification and discussion contributes to theory in five ways. First, we extend the study of the liability of foreignness beyond an understanding of its *consequences* to an understanding of the underlying *causes* of the difficulties firms face when they internationalize in search of new markets. This is an area that has received remarkably little in-depth attention, despite its importance for understanding the challenges that firms encounter when they internationalize.

Second, by using one theoretical approach our study clarifies in a systematic manner the relationship among the diverse list of potential causes that have been mentioned in the literature. Previous studies have indicated a variety of factors that cause the difficulties and lead to higher costs (for a recent review of the costs, see Eden and Miller, 2001), such as unfamiliarity with the foreign market (Hymer, 1976), discrimination by

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the host government (Buckley and Casson, 1976; Hymer, 1976), additional coordination and communication needed to manage spatial distance (Vernon, 1977), lack of legitimacy (Kostova and Zaheer, 1999), lack of membership in information networks (Zaheer, 2002), or additional complexity (Tallman and Li, 1996; Hitt *et al.*, 1997). By using a single theoretical lens we organized these causes in a coherent framework, and are able to show that few of the causes are exclusive to international expansion. The two that are exclusive – the disadvantage of foreignness and the liability of foreignness – are intimately related to the social and institutional dimensions of a foreign country. The other difficulties in our typology can be suffered by firms expanding within a single country, across industries, or across market segments. However, firms that expand across borders are more likely to suffer several of them at the same time. The framework outlined in this paper enables future empirical analyses to move toward more fine-grained tests that separate different types of difficulties in internationalization by their cause. This will expand our understanding and help explain conflicting findings.

Third, by adopting a RBT stance, we move away from analyzing difficulties in internationalization as the additional costs foreign firms incur, and toward a discussion that also includes reduced revenues. In fact, an increase in costs is commonly the consequence of solving a difficulty in internationalization rather than its cause.

Fourth, our analysis extends current work in RBT by redirecting attention toward the resources a firm *lacks*, not just the resources a firm already has. RBT has increasingly been used in the field of international management (e.g., Collis, 1991; Tallman, 1991, 1992; Madhok, 1997; Peng, 2001), but has focused primarily on the advantages that MNEs draw from existing resources (see Tallman and Yip, 2001, for a recent review), not the additional resources required.

Fifth, and finally, we contribute to RBT by expanding the discussion of how the advantage provided by a resource can vary across locations. Other research has identified that the advantageous nature of resources can change over time (Miller and Shamsie, 1996) and with a changing competitive environment (Teece *et al.*, 1997). Our work adds considerable depth to work that initially recognized that the advantageous nature of resources can change in new host country environments (Tallman, 1992; Hu, 1995), and that resources can also become disadvantageous abroad, even when they were the source of advantage at home.

Our analysis also has practical implications. As the opening example illustrated, despite the apparent advantages that a firm may have at home, internationalizing is difficult. The framework and solutions discussed in this paper will help managers target solutions to the root causes of the difficulties encountered, or avoid them altogether by doing thorough analysis up-front. Unlike other RBT analyses, the solutions we present go beyond the simplistic argument of using advantages to compensate for difficulties.

Our paper has some limitations that suggest additional avenues for future research. First, we centered our attention on firms internationalizing in search of new markets. Future research can adapt the typology presented here to study the difficulties in internationalization suffered by firms that expand abroad to obtain resources (natural, strategic, or knowledge). Firms will suffer difficulties in internationalization regardless of the motivation for foreign expansion, but the importance and specifics of the difficulty will vary. For example, when firms internationalize in search of new markets, the primary motivation is to transfer the advantage provided by existing resources to a new country. In such case, a lack of complementary resources may not be as salient a concern, at least not initially. In contrast, when internationalizing to obtain resources, the primary motivation is to access better or different resources in the new country. In this case, the lack of such resources may be more salient than the loss of advantage or the creation of a disadvantage, since this was the primary motivation for the expansion. Moreover, there are other aspects of the difficulties that differ, depending on the motive. For example, the inability to create value, the liability of newness, and the liability of infrastructure are all associated with the firm's relationship with customers in the new host country. Firms that internationalize to access resources are less likely to be concerned about the customers in the new country and more likely to be concerned about their relationship with the government (which may control access to natural resources through a license system) and with individual employees (who may control the knowledge sought, or are the resource that helps improve efficiency). Future research can build and extend the framework outlined here to analyze these

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subtleties in the difficulties in internationalization when the company expands abroad in search of resources.

A second limitation of our analysis that can be the basis of future research is that we chose to explore the difficulties faced by firms in a single country in order to develop a parsimonious framework. However, the difficulties faced by a firm may vary when it expands into multiple foreign countries at the same time, and when it is present in several countries. When the firm enters or operates in multiple countries, the relationship between resources and the context will vary by country, and difficulties may interact to produce situations that may be detrimental in one country and beneficial in another. For example, facing a variety of difficulties simultaneously may put a strain on a firm that is greater than the 'sum' of those difficulties. Alternatively, facing similar types of difficulties in various contexts may provide experiential learning that helps firms overcome difficulties sooner than they would have otherwise. Future studies can consider configuration patterns across various difficulties, and can address the heterogeneity of difficulties suffered not only across firms, but also across host countries.

A third limitation that can serve as a building block for future studies is the focus on difficulties to the exclusion of advantages. The firm can use its advantages to compensate for some of its difficulties. It can also find that some of the resources that it transferred and that did not provide an advantage in existing operations become a source of advantage in the new country. Future studies can analyze the interactions between advantages and disadvantages on the competitive behavior and performance of the operation in the new country.

Fourth, and finally, in this paper we implicitly discuss the difficulties faced at the point of initial international expansion. Over time the firm may overcome the difficulties in internationalization and achieve parity with local companies in terms of likelihood of survival (Zaheer and Mosakowski, 1997). This alone does not ensure that it will achieve a competitive advantage and the associated superior profitability in that foreign operation, but only that the foreign operation and the incumbent local firm will be equally likely to perform well or poorly. The foreign operation may achieve a competitive advantage if resources it transfers from other operations or develops in the host country provide it with an advantage over local competitors. Future research can explore the interaction between the difficulties and the advantages of the firm in determining the success of the internationalization effort over time.

In summary, we adopted the perspective of RBT to disaggregate difficulties associated with internationalization into their respective root causes. We encourage future research that embraces the multidimensional nature, and therefore a deeper understanding, of these difficulties.

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Notes
[1]Empirical studies have analyzed the consequences of these difficulties, finding that subsidiaries of foreign firms have lower performance (Zaheer, 1995), are more likely to exit markets (Zaheer and Mosakowski, 1997), face more lawsuits (Mezias, 2002a), and are less efficient (Miller and Parkhe, 2002) than domestic firms. However, foreign firms are not always at a disadvantage; some studies find that domestic and foreign firms have similar chances for survival (Mata and Portugal, 2002), and that foreign firms acquire better-performing companies than do their domestic counterparts (Goethals and Ooghe, 1997).

[2]Another form of international expansion is licensing (Buckley and Casson, 1976). Licensing is typically initiated by the licensee in the foreign market, who bears the costs of the various liabilities if the licensed technology or brand fails to deliver. The licensor is generally paid up-front and therefore avoids difficulties in internationalization. We thank an anonymous reviewer for this suggestion.

[3]Although the term 'liability of foreignness' was initially introduced as a synonym for the costs of doing business abroad or overall difficulties (Zaheer, 1995), in later studies it was narrowed to represent difficulties that arise from the lack of social relationships abroad (Zaheer, 2002). Here we adopt the narrower definition of the term.

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