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## THE USEFULNESS OF NETWORK KNOWLEDGE

Kent Eriksson, Angelika Lindstrand, Anders Majkgård  
Uppsala University  
Department of Business Studies  
Box 513  
S-751 20 Uppsala  
Sweden  
phone +46 18 471 13 55  
fax +46 18 4716810  
e-mail anders.majkgard@fek.uu.se

D. Deo Sharma  
Copenhagen Business School  
Department of Marketing  
Struenseegade 7-9  
2200 Copenhagen  
Denmark  
phone + 45 381 521 19  
fax +45 381 538 15  
e-mail deo.sharma@cbs.dk

### ABSTRACT

This paper examines the usefulness of network knowledge in the internationalization process of the firm. Based on learning theory, we discuss the usefulness of knowledge in the internationalization process of firms. An explorative LISREL analysis indicates that duration in foreign markets affects variation in geographical markets which in turn affects both customer knowledge and network knowledge. The results show that customer knowledge and network knowledge are used differently in the internationalizing firm.

## INTRODUCTION

The importance of experiential knowledge in international business and marketing literature is well documented. It has been observed that in the process of internationalization and foreign market entry decision in firms is driven by their experiential knowledge (Johanson and Vahlne, 1977; Cavusgil, 1980; Kogut and Zander, 1993; Eriksson, Johanson, Majkgård, and Sharma, 1997; Madhok, 1997, Makino and Delios 1996). Also, in strategy literature an increasing emphasise is being placed on experiential knowledge of firms (Prahalad and Hamel 1986). By experiential knowledge is implied knowledge that firms accumulate by being active in the market (Penrose, 1959). Experiential knowledge is firm specific. The term experiential knowledge in this context consists of all types of knowledge that firms accumulate by being active in foreign markets. At an aggregate level experiential knowledge may concern knowledge on local business and local institutions (Eriksson, et. al., 1997).

Most learning theories argue that organizational learning manifest itself in organizational actions. Argyris and Schön (1978) state, for example, that organizations learn when they ‘respond to changes in the internal and external environments of the organization by detecting and correcting errors in theory-in-use.....’ (p. 23). Evident in this description is the use of knowledge by firms to detect errors and take corrective action and that not all knowledge is of equal use in this process. The same holds for internationalizing firms. Little research exists on the nature of experiential knowledge in firms.

In previous research little attention is paid to the issue of the usefulness of experiential knowledge in firms. The purpose of the paper is to investigate the usefulness of customer knowledge and network knowledge in internationalizing firms. Are customer knowledge and

network knowledge used different in the internationalizing firm? We base our discussion on three interrelated fields: network and internationalization literature and learning literature.

The usefulness of knowledge may touch upon problem definition, development of alternative courses of action, their evaluation, and the making the final selection among the alternative courses of action. Studying which knowledge managers perceive as useful is important for a number of reasons. As this is likely to influence action by the internationalizing firms the knowledge used by decision makers is likely to influence the final outcome or performance in the internationalization process of firms. Moreover, as internationalization is a journey in the unknown (Johanson and Vahlne 1977) the scanning of the environment, its interpretation, and diagnosis is contingent upon the current stock of knowledge, but also on what is perceived to be useful by the decision makers. This is as making use of the current stock of knowledge will demand retrieval of information from the memory. That decision makers in firms perceive a certain piece of knowledge as being useful is not to claim that these perception are necessarily correct.

The paper is structured as following. We begin with a discussion of the internationalization process and usefulness of knowledge. Then, we describe our empirical method and present the structural model. Lastly, the preliminary results are presented.

### **USEFULNESS OF KNOWLEDGE**

By usefulness of knowledge is implied the ability of the knowledge to provide decision makers a rational for making decisions, thereby promoting action (Menon and Varadarajan, 1992). The usefulness is related to using a knowledge in a particular decision making. The usefulness is determined by (1) its meaningfulness (knowledge makes a sense to the user), (2)

goal relevance (knowledge is related to the task at hand, (3) operational validity (something can be done with the knowledge, and (4) innovativeness (the knowledge is none-obvious) (Shrivastava, 1987). Menon and Varadarajan (1992) state that usefulness is ‘the perceived potential the information has for usage’ (p. 66). The usefulness of knowledge may be for instrumental, conceptual, or symbolic purposes (Menon and Vadarajan, 1992).

The behavioural based internationalization literature is emphasising the importance of knowledge and learning for internationalizing firms (Johanson and Vahlne, 1977, 1990). Recent research on internationalization process of firms is supporting the idea that internationalization is a trial and error based learning process and a journey in the unknown. In this literature it is argued that in the process of internationalizing actions taken by firms is both an ultimate effect of learning as well as the ultimate source of learning for firms. This is very similar to the arguments made by learning theoretician such as Argyris and Schön (1978), Levitt and March (1988), and Senge (1990). Consequently, in this paper we base our discussion on learning and knowledge theories (Levinthal and Cohen, 1994; Argyris and Schön, 1978; Johanson and Vahlne 1977).

The basic structure of our argument in this paper is as following. Based on the huge amount of research on the internationalization of firms we accept the argument that experiential knowledge drives internationalization of firm. The initial stock knowledge that firms accumulate is through their operation in the domestic market. It is argued that the current stock of knowledge that drives the course of internationalization of firms. The current stock of a firms knowledge shapes the ‘absorption capacity’ of an internationalizing firm (Levinthal and Cohen, 1994). The current stock of knowledge also determines what the firm perceive as being useful, and worth learning. In this paper, therefore, we argue that the usefulness of

knowledge in internationalizing firms is determined of their current stock of knowledge. Thus, firms possessing different types and amounts of experiential knowledge result in different types of capability in internationalizing firms. Thus, the current or the initial set of knowledge in firms will be determining what decision makers in firms perceive as useful for their future internationalization. Firms with different types of knowledge or different amounts of knowledge may be perceiving different components of knowledge as being useful. This knowledge may concern a firm's immediate client, its clients client, its suppliers, its suppliers-supplier, and its competitors. Either of these could be domestic or foreign.

A common starting point of almost all the internationalization process studies is the assumption that firms initially operate locally and that their knowledge reflects their operations in their local contexts (Bilkey 1978; Johanson and Vahlne 1977; Perlmutter 1969; Vernon 1966). This knowledge is embedded in the internal aspects such as strategies, routines and administrative structure, and external aspects such as products, and promotions of firm. When they go abroad, firms base their activities on those domestic market based internal and external artefacts developed by firms. These, however, frequently does not help them to understand situations and conditions in specific foreign markets. Firms must learn both about doing business abroad and about the conditions in particular foreign markets. This requires experience gained over time from doing business in those markets.

Since the internationalization process is characterized as a process of learning and knowledge development, we base the following discussion on organizational learning literature. According to Duncan and Weiss (1979: 84) learning is 'the process within the organization by which knowledge about action-outcome relationships and the effect of the environment on these relationships is developed'. (de Geus, 1988:70) defined organizational learning as 'the process

whereby management teams change their shared mental models of their company, their markets and their competitors'. The extent learning literature, as well as, internationalization process theory, states that firms learn from their past experience by transforming this experience to useful knowledge. Learning is an incremental, phenomenon unfolding over time and linked to current and previous knowledge (Cohen and Levinthal 1990; Garvin 1993). This is organizational memory or theory-in-use. According to March and Simon (1958) organizational memory contains operating procedure. March and Olsen (1976) state that past events, promises, assumption, and behaviours are stored in the memory of firms. Hall (1984) states that organizational memory contains causal maps, strategic orientations, and standard operating procedures. Starbuck and Hedberg (1977) state that knowledge deposited in memory of firms become obstacles to change and lose their efficiency. Thus, not all knowledge deposited in the memory of internationalizing firms is useful. The usefulness of knowledge is contingent on the retrieval process in the firm, and its accuracy. Consequently, what knowledge organization perceive as useful is contingent on the belief systems of firms concerning their environment and in their methods of intruding into it (Daft and Wieck, 1984). This way of looking into firms assumes existence of organizational memory.

Argyris and Schön's (1978) state that organizations act on the basis of their theory-in-use. Theory-in-use implies an explicit or implicit understanding on how things are done. It can be specified in terms of Duncan and Weiss's (1979) definition of learning given above. Theory-in-use is embedded in the internal routines, norms, values, and strategies of an organization and external organizational actions such as products, promotion, and distribution. Organizations learn when as they respond to changes in external and internal environment of the organizations. This happens as organizations detect errors and take actions to correct the same.

These actions lead to organization-environment interaction leading to (dis)confirmation of their beliefs about cause-effect relationships. Accumulation of internationalization knowledge in internationalizing firms is, consequently, a cyclic phenomena. In the context of internationalization lack of internationalization knowledge is perceived when the theory-in-use is vague, undifferentiated or irrelevant. Such lack of internationalization knowledge leads to, as mentioned above, lack of business and institutional knowledge about foreign markets. Internationalization knowledge is the shared vision of the firm and guides its future internationalization. This is identical to theory-in-use and associated routines, and norms (Argyris and Schön 1978; Corsini 1987; Fiol and Lyles 1985), interpretative scheme (Ranson and Greenwood, 1980), or organizational frame of reference (Shrivastava and Schneider 1984). When the theory-in-use is applied to business problems that evolve, errors are detected and corrections are made. In this process managers perception on what knowledge is useful or not in order to analyse, and resolve problems is important.

Organizational learning is a process involving a number of different steps, e. g., information generation (or what information is collected), dissemination (what is shared with others), interpretation (what meaning is given to the information), and information storing for future use (Huber, 1991; Sinkula, 1984). All these steps impact what is perceived as being useful by decision maker's in firms. Decision maker's perception on what is useful may lead to what information is generated, disseminated, interpreted, and stored in the memory by firm. Without collecting information on its clients, suppliers, clients-client, competitors an internationalizing firms would not know the market. No use of the information is feasible. Similarly, without disseminating the information that is collected in firms it can not be used. Also, the use of information would demand its interpretation, which in turn is contingent

upon the experiential knowledge in firms. As stated earlier, experiential knowledge in firms also form their mental model on how the world functions and the theory-in-use. This tells to firms the relationships between cause and effects. This, in turn, guide decision makers behaviour including what information decision makers perceive as (not)useful (Slater and Narver, 1995).

The mental model held by firms or their theory-in-use determine what the internationalizing firms perceives as being useful. This is so as firms seek solution to their problems in the vicinity of what they have done in the past (Cyert and March, 1963; Cohen and Levinthal, 1994). In the process of internationalization the experience is interpreted and evaluated based on the firm's theory-in-use.

### **USEFULNESS AND PERFORMANCE**

The use of a particular piece of knowledge by decision makers imply that the knowledge stored in firms is brought from where the knowledge is stored. This retrieval process could vary from being very automatic to controlled (Kahneman, 1973). An automatic retrieval happens when a piece of knowledge is used as function of past habits. Controlled retrieval takes place when decision makers consciously analyse a situation, seek knowledge, and apply it to a decision situation.

Huber (1991), and Cyert, Kumar, and Williams (1993) argue that differences in the starting model held by firms can result in differences in performance. Cyert, Kumar, and Williams (1993) argue that operating experience of firms contribute to their capability. They argue that firms seek to collect, interpret, disseminate and interpret knowledge on their clients, their profile, and their preferences. By operating in the market firms accumulate knowledge on



client's reaction to a firm's marketing strategy, its product, pricing, services, and promotion. Initially these form the theory-in-use and the 'absorptive capability' of the firms. Gradually, however, through an iterative learning process firms improve their models of the market. As firms operate in a market, their knowledge level is improved and their profile of clients is changed. In other words, decision makers in firms use mental models on market and clients to collect, disseminate, interpret, and store information on clients. The usefulness of these mental models on clients is contingent upon the extent to which these reflect the realities on clients, their profile, and their behaviour. A knowledge of clients, their profile, and their preferences is useful for firms. Generally, in the process of internationalizing the initial mental models on clients that decision makers hold is based on their domestic experience and it is flawed. Gradually, as the stock of knowledge by firms improves their mental model on clients improves as well.

But, in the process of accumulating knowledge on clients and developing models on them firms also accumulate knowledge on and model competitors (Ingram and Baum, 1997). Firms develop a picture of their competitor, their attributes, the products and services that competitors supply and have a direct bearing on the performance of a focal firm. Through operations in a market firms accumulate knowledge on their competitors, who they are and their strategies (White, 1981). In order to achieve success firms need to understand their competitors, how would they interpret any decision or action by the focal firm. Not doing so may lead firms to competency trap leading to failures.

Research shows that organizations' ability to learn is restricted by organizational inertia. Due to organizational inertia, Stinchcombe (1965), and Argote, Beckman and Epple (1990), argues that organizations are mostly influenced by their environment at the time of their establishment.

Hannan and Freeman (1984) argue that costs as risks associated with organizational learning and the accompanying changes make such changes difficult.

Research shows that people with more experience or experts use their knowledge through heuristics to make decisions (Harmon and King, 1985). In marketing literature experience have been found to affect the use of information. For example, sales person with more experience have more knowledge in memory, they know more about clients and know more about selling strategies (Sujan, Sujan and Bettman, 1988). Experienced decision maker's are likely to search for more information, simultaneously restricting themselves to relevant information. Thus, they are in a better position to be selective and be able to differentiate between relevant and none-relevant information (Brucks, 1985). Experience determines the valuation or usefulness of information.

The characteristic of the task at hand is likely to affect perception of the usefulness of knowledge. Environment surrounding a firm could vary from being turbulent and fast changing to simple and stable. Turbulent environments increase perception of uncertainty for decision makers. Uncertainty develops because of the lack of definitiveness of future and a particular course of action taken by firms. Availability of 'right' or 'useful' information and knowledge to decision makers may reduce the uncertainty faced by firms. The more uncertain the decision situation that firms face the information more 'credible' information they require.

Thus, we expect that the use of knowledge by firms will be different depending on if the additional assignment that the firm is carrying out is in a new market or if it is in a market in the firm is already active. The task of carrying out a new assignment or an assignment in a new in a new market is both more difficult and more variable. The current stock of

knowledge in firms may not be enough for analysing and, then, executing such a task. Analysing such a task is more difficult. To execute such a task more information and more varied information is needed. On the other hand, if the additional assignment is in an established market, or if the additional assignment is a mere extension of an ongoing assignment, the perceived usefulness of external knowledge is likely to be less. Such firms are likely to be more discriminating in their perception as they already possess knowledge on local institutional situation and clients. Their current stock of knowledge may allow them to be more selective.

### **THE DATA**

Data have been gathered by questionnaire within the ongoing research project Learning in the Internationalization Process. A pilot study was conducted in 1997 in which ten Swedish firms with international operations were asked to answer the questionnaire in an interview situation. The final standardized questionnaire was sent out in 1998 to managing directors in Swedish manufacturing and service industries with international operations. The Swedish Trade Directory was used to find the addresses of suitable companies. Consequently, the sample is not an independent random one. The firms vary in size, industry sector and geographical location. 176 questionnaires were returned. The response rate was approximately 35%. All of the questions are of a close-ended nature, using a seven point Likert scale ranging from completely agree and completely disagree. Most of the variables are perceptual measures, but there are also objective measures.

In this paper the focus is upon a specific international business assignment. Respondents were asked to select a business assignment that is important to their firm and through which

their company is expanding internationally. This assignment should preferably be well underway so that the company would already have started doing business with the counterparts. If this was not possible, the respondent was asked to choose a recently finished assignment. Examples of such assignments that could be selected are:

- A contract with a new distributor or agent in a new country.
- A considerable expansion of the business conducted with an existing customer.
- Doing business with one or more new customers within an existing market.
- Entering new country markets with existing customers.
- Doing business with new customers within a new market.

### **THE TECHNIQUE USING LISREL**

We examined whether it was possible to form a smaller set of meaningful constructs that capture much of the variation in the variables described in the previous section. This was done with the help of the LISREL method, a technique for tracing structural relations in a data set (Jöreskog and Sörbom 1993). The technique is unique in that it puts stringent requirements on validity by using the correlation estimate and the correlated error terms as two independent sources against which patterns of variation in the data are tested. Even though these stringent requirements are sometimes difficult to meet, they facilitate advanced tests of causalities in a data set. The technique also tests for constructs, which are higher-order representations of the common, underlying commonalties that have been observed in a set of indicators.

The validity assessment is done by testing that the constructs are indeed separate from one another, and that together they make up a valid pattern of structural relations in a model. The

LISREL program gives the user powerful tools for assessing this validity. Perhaps most helpful is the modification index, which presents a graphical interpretation of the strongest disturbances in the model. It may, for instance, be revealed that two constructs load on the same indicator, which means that they can not be discriminated between. In other cases, patterns of correlation's between error terms may reveal that the relation between two indicators needs to be underrepresented in the model for it to be valid.

Exploration of patterns of variation in the data with LISREL hinges on the use of the graphical modification index, which helps the researcher to re-evaluate or arrive at theoretical explanations. The common procedure is for the researcher to start with a hypothesized model, and then change it in the light of modifications suggested and substantive theory. At best, the dialectic between the empirical material and theories provides fertile soil for a better understanding of both empirical material and theories. However, there is a need to recognize that the final results should rest on firm theoretical grounds in order to be acceptable. Valid patterns in data are not enough in themselves.

It takes time to develop unique relationships, and thereby different kinds of useful knowledge. This kind of market knowledge is a product of the firms' duration in international business operations, and the variation of its business operations. Variation in international contexts mediates the learning capacity of the firm. According to the internationalization models, variation is an intermediate construct between duration and experiential learning, i.e., variation facilitates foreign experiential knowledge development, but it takes time to build operations in different countries and, consequently, to create variation.

Table 1 below shows the constructs and their indicators.

**TABLE 1**  
**THE CONSTRUCTS AND THEIR INDICATORS**

<b>Constructs and Indicators</b>	<b>Indicator label</b>	<b>Factor Loading</b>	<b>T-value</b>	<b>R2-value</b>
<i>Foreign customer experience</i>				
When carrying this assignment out it is useful to have had previous experience of customers abroad	CA	1.00		
<i>Foreign network experience</i>				
When carrying this assignment out it is useful to have had previous experience of				
suppliers abroad	SA	0.58	6.06	0.34
customer's customers	CC	0.55	5.83	0.30
competing suppliers	CS	0.66	6.55	0.44
<i>Duration</i>				
Number of years since first international business assignment (log transform)	DURATION	1.00		
<i>Variation of experience</i>				
approximately how many countries do you operate in (log transform)	VARIATION	1.00		

<sup>1</sup>The indicators are identical with the questions put to respondents.

The first construct “Foreign Customer Experience” refers to the usefulness of previous experiences of customers abroad.

The construct “Foreign Network Experience” refers to the usefulness of having previous experience of supplier's abroad, customer's customers and competing suppliers.

The construct duration is often measured as an objective question concerning the time for the first international operation. In line with that, we measure duration by asking managers: Which year did the firm start doing international business?

Variation is often measured as the geographical dispersion of the firm (Erramilli 1991). Consequently, variation was measured by asking the respondents: To how many countries do you sell?

All key statistics for the four measures are good. The t-values are all above 6.05, factor loading are above 0.65, and the  $R^2$  – values are above 0.33. The t-values and  $R^2$  – values indicate good convergent validity.

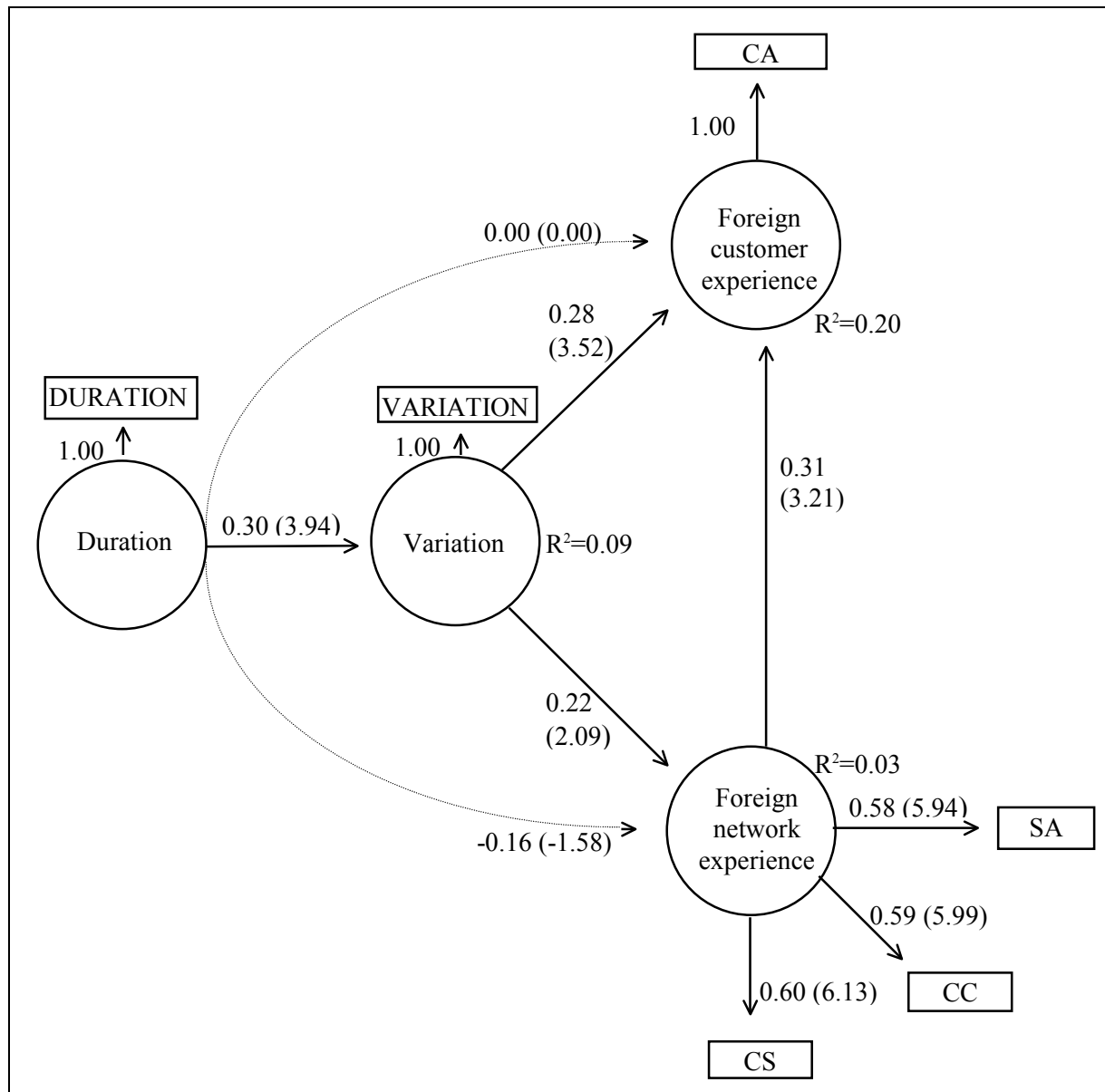
## RESULTS

As discussed earlier, it is expected that the internationalization experience comes from the variation in markets, which is an antecedent to the usefulness of previous business relationship experiences. It is also posited that duration determines variation, since internationalization takes time. A structural model was therefore made with duration as independent variable, effecting variation, which then effects both foreign customer experience and relationship network experience. Figure 1 displays such a model.

The results in Figure 1 clearly show that variation is stronger than duration on the usefulness of relationship experience. The results also show that duration has a strong (0.30 in Figure 2) effect on variation. This shows that duration is a prerequisite for firms to develop an ability to use their experiences, and that variation is necessary for this development to happen. Variation is thus more essential than duration for experience to develop, but variation results from duration.

The results in Figure 1 also show that variation increases the usefulness of both foreign customer experience (0.28) and foreign network experience (0.22). This shows that variation in markets increases a firm's capability to use their prior business relationship experiences. Apparently, firms develop routines for using prior experiences as they gain in international experience.

**FIGURE 1**  
**THE STRUCTURAL MODEL**



Note: Figures are factor loadings, with t-values in parentheses. Chi-square is 5.50, with 6 degrees of freedom, at a probability of 0.48 (significant at the 5%-level).

The results also show that foreign network experience increases foreign customer experience (0.31). This shows that foreign customer experiences often are associated with foreign network experiences. Presumably, the network experiences are a context to a specific relationship, and in many cases it is necessary to understand how to use these contextual



experiences before the foreign network experiences can be used. For instance, it may be that the network experiences are useful in a foreign business assignment that a firm has committed extensively to. Or, the other way around, perhaps the early stages of relationship development includes a more limited understanding of the context, which makes the firm less able to use their network experiences.

However, foreign network experience and foreign customer experiences are distinctly separate, as shown by the discriminant analysis. It is often argued that the customer experience and the network experience not are two distinct analytical dimensions, but that they merge into one complex whole. The present results do not contradict such an argument. The results in this study are that the past experiences of customer relationships and the networks are used differently. It may well be that relationship and network are inseparable entities in ongoing business, but this is not studied here.

The results presented in Figure 1 show good statistical key figures in all cases but two. These are two poor  $R^2$  values that concern the causal relations going to variation ( $R^2=0.09$ ) and to relationship network experiences ( $R^2=0.03$ ). This means that the linearity of the relationship is poor, but it should be noted that the relationship is significant and reasonably strong. The implications of the results is that it is difficult to understand how variation and relationship network experiences are caused by their respective independent constructs. This is not unexpected.

Analysis of frequency distributions shows that the network experience variables are not normally distributed. There seems to be firms who consider network relationships useful, and those who do not. The low  $R^2$  value and the frequency distributions together suggest that the sample contains two groups of firms. We may speculate that this duality is due to the depth of

involvement in the ongoing assignment. The question asks respondents to select an assignment, and then answer questions on the usefulness of customers and network connection categories in relation to this assignment. Presumably, uses differ between an assignment where respondents have a considerable and a low degree of involvement.

## **DISCUSSION**

The explorative analysis show that the use of previously developed experiences from business network relationships is a complex matter. While many studies point to business networks as one entity, the present results show that it is a multifaceted phenomenon in the minds of business people. Customer experiences seem to be very different from experiences from the rest of the network. And there seem also to be good grounds to assume that there are different uses of supplementary suppliers and competing suppliers for firms that are familiar or unfamiliar with the ongoing assignment.

These findings indicate the importance and complexity of networks. All the preliminary results show that firms use their past experiences more as they gain in experience from more international markets. This shows that experiences can be applied in different markets. Other results also show that firms with a high degree of internationalization knowledge detect more differentiated knowledge structures in specific markets (Eriksson, Johanson, Majkgård and Sharma 1997). This suggests that experienced firms develop routines for going international, which then increases the rate at which they gain deep knowledge about specific local markets. However, this does not automatically imply that experiences can be transferred. There are additional pieces of information that need to be gathered before more firm conclusions can be drawn. An important issue may be the depth of the experience in the assignment in which the

experiences are used. It can be expected that firms that are deeply involved in an international assignment become more aware of the ways in which it is unique, and this may cause them to be more discerning about which experiences they can use.

The fact that firms develop knowledge both from many diverse country markets, and from the depth of involvement can be fruitfully combined into a research framework for future studies. It may seem plausible that firms with diverse experiences have learned more about what to look for when developing a specific assignment. Put differently, firms with more diverse country market experiences have knowledge structures concerning development of specific assignments that are different from those of firms with homogenous market experiences. Likewise, it may be expected that the more deeply involved a firm is in an assignment, the more unique and discerning is the applicability of their knowledge generated from diverse markets. Firms with more diverse experiences may capitalize on their knowledge in the initial development of business assignments. But as firms become more deeply involved in a relationship, the more unique it becomes, and the less applicable the knowledge. However, all this is speculation and should be studied more carefully in the future.

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