

# **Japanese Professional Business Services**

## **-Theoretical implications of internationalization**

### 2.1 Market entry and locational strategies

Working paper

#### **Authors:**

**Patrik Ström**  
Center for Service Studies  
Roskilde University  
Box 260, DK-4000 Roskilde  
DENMARK  
Email. [strom@ruc.dk](mailto:strom@ruc.dk)

**Jan Mattsson**  
Center for Service Studies  
Roskilde University  
Box 260, DK-4000 Roskilde  
DENMARK  
Email. [mattsson@ruc.dk](mailto:mattsson@ruc.dk)

#### **ABSTRACT**

The paper deals with the internationalization process of Japanese business service firms. This is a sector of great importance, but it has been neglected in research on Japan, which has mainly focused on the manufacturing sector. It has been found that the service sector in Japan seems to be less developed, than its Western counterparts. This has also had implications for the international growth of Japanese business services. The aim is to extend the OLI paradigm and construct a model, which can later be empirically tested through statistical or case study analysis. In order to generate a solid understanding for the complex industry, the theoretical framework takes its stance in three theoretical areas; service management, economic geography and internationalization theory. This theory cross pooling approach reveals that important fundamentals for a strong business service industry seem to be lacking in Japan. This together with the cultural environment and tight corporate structure has generated an internationalization process, which can either be called introvert or extrovert. Here, the connections within the single company or business group (Keiretsu) differ, which affects the way of internationalizing. The paper reveals that the old way of distinguishing between pure internalization and externalization might be misleading in the case of Japanese business services.

**Key words:** Japan, Internationalization process, Business Services, Theory cross pooling, Introvert/Extrovert

## Introduction

Since the Japanese industrial catch-up after WWII, much of the business and academic focus has been put on the Japanese manufacturing industry. Researchers and managers have witnessed and explored a tremendous development of the Japanese economy, though the 1990s market stagnation. Not only did the Japanese companies expand through export, soon they were important players in the field of FDI. Less attention however has been put on the development of the Japanese business service sector. Statistics show that Japan is lagging behind in service industry development. Most of the mature and highly developed economies in the OECD are about ten percent ahead of Japan, measured as the service sector's share of total to GDP and employment. (OECD, 1999) In addition, Japan shows a large trade deficit in service trade, which has also resulted in a low export ratio. (Ibid.; WTO, 1999) The aim of this paper is to analyze the pattern and underlying factors of the internationalization of Japanese business services, building on three main theoretical perspectives. These are service management theory, economic geography theory and internationalization theory. By combining these perspectives the purpose is to generate a model for later empirical testing in the search for better and deeper understanding of the operations of Japanese business services companies in the global economy. This kind of international research on business-to-business relations dealing with cultural differences and patterns of internationalization, together with a more integrative approach, has been stated as something relatively unexplored and needs further research. (Reid & Plank, 2000:135) Regarding definitions, this paper uses the terms "professional business-" and "business services" interchangeably in order to capture the knowledge intensive financial services sometimes found in the broader term. (see e.g. Hermelin, 1997)

## The Japanese service industry

Most of the research focus about the Japanese economic development has been concentrated in the field of manufacturing. Few attempts have been made in analyzing the development of the Japanese service sector, both in terms of domestic and international analyzes. However, the fact that the Japanese economy seems to be less influenced by the service sector, judging by the relative low contribution to GDP, employment rate within services and the low export ratio, indicates that a proper analysis is needed. (See table 1) The situation generates the foundation for looking at the internationalization process, or maybe even lack of internationalization compared to services industries in the West.

Table 1: Global comparison of service industries (percent)

<i>Country</i>	<i>Contribution to GDP</i>		<i>Employment share</i>		<i>Export ratio</i>
	1987	1997	1987	1997	1997
Canada	66.8	71.6	70.0	73.0	6,7
France	66.9	71.5	62.2	69.9	8,1
Germany	64.0	69.9	55.4	60.2	5,2
Italy	61.9	66.9	56.8	61.2	9,4
Japan	56.8	60.2	57.9	61.6	2,7
UK	66.1	70.8	64.8	71.3	9,4
USA	68.3	71.4	69.9	73.4	4,1

Source: OECD in figures 1999, Own elaboration based on OECD in figures 1999 and WTO: <http://www.wto.org/wto/statis/ee.htm>, September 30, 1999

One can speculate over the reasons behind the fact that research about the Japanese service industry also lags behind. The most likely explanation is that, because of its relatively underdevelopment, and its low impact on the international market it has been almost neglected. This also connects to the fact that the rapid industrialization and the economic catch-up were more or less completely focused on manufacturing industries. Nevertheless, some research exists, but there are differences in terms of research field. There is a tendency for research to focus on the consumer and retailing

side and also the financial aspects. This becomes even more evident when studying the literature regarding internationalization of the Japanese service sector. Some researchers like Davies & Jones (1993) and Clarke & Rimmer (1997) have studied the internationalization of the Japanese retailing industry. The former shows the presence of Japanese retailers around the world and it shows the dominant influence of Japanese retailers in the Far East. The latter on the other hand describes the internationalization within the sector, focusing on the operations of Japanese retailers in Australia. The underlying reason for the interest in the retailing sector is of course the large number of big Japanese department stores and their early success.

In Europe the UK has over the years attracted the most part of Japanese FDI. In the case of manufacturing the share has been around 30 percent throughout the 1990s. (OECD, 1998) This should be a solid foundation for attracting FDI within the service sector based on the findings by Mardas et al. (1998), stating that services follows their customers abroad often in business networks. Furthermore, the total service investments in the UK have risen from 32 percent in 1987 to about 50 percent in 1997. (OECD, 1998) Comparing this with the fact that service related FDI in general from Japan already in 1986 constituted of more than 50 percent of the total FDI, may generate a picture of Japanese service industries as highly internationalized. Important to remember is however that much of the investments made by Japan has been purely financial or related to real estate. This is revealed by a closer look at the non-manufacturing FDI, where the share has been about 50% since the mid 80s, with only a few exceptions. (JEF, 2000; MOF, 2000)

## Japanese investments in the UK

The Japanese investments in the service sector appeared already in the 1950s. Since then, the investments in the UK have increased. The two main reasons for investing in the Greater London area have been following customers abroad and the pure attraction due to the financial importance of the city in the world economy. Additionally, factors such as the appreciation of the yen and fear of trade friction in connection to the creation of the single market, have been incentives for investing in the Europe. (Yoshitomi, 1990) According to Trevor (1985) there are mainly four general reasons behind the fact the UK has attracted most of the Japanese investments in Europe, both within services and manufacturing. Firstly, the British government supported by its regional and local bodies has for long had a positive attitude towards Japanese FDI. Secondly, the Japanese have experienced good industrial relationships. It has been relatively easy to start and remain in business. Thirdly, the language is of course a big advantage since the first foreign language in Japan is English. Finally, all the aspects put forward above have helped the UK to continuously attract Japanese FDIs. Additionally, an initial success of a few companies and the creation of a Japanese community also work in an attractive manner. In spite of early service investments made in the financial area, followed by a tremendous increase in manufacturing FDI, one can question the diversity of the Japanese service investments in Europe and the UK. The fact that companies need financial and trading operations assistance abroad is obvious and not special in the Japanese case. More interesting is the type of investments made and their diversity. By judging from the statistics presented in Table 1, Japan seems to lag behind in terms of their service industry. The question is how this can have affected their international operations. Except for the Sogo shoshas and the financial institutions, there are relatively few Japanese service

operations working world-wide, compared with the situation in many of the OECD countries. One aspect of this can be seen in the way the financial services and banks internationalized in the 1980s. The incremental and precocious approach used in manufacturing has been of value. Instead of going into deep water, with little knowledge, the financial institutions have started out with segments where they are strong, such as governmental lending. These low risk operations will be the foundation for expanding further. To obtain knowledge in more complex banking, joint operations are used in the Japanese domestic market. The gains for the Western counterparts have been low, but for the Japanese the knowledge have been of great value. (Wright & Pauli, 1988) This capacity of learning, has been a very useful tool in establishing global presence. It is most likely that this incremental process exists in the business service industry as a whole and therefore hinders a more risk prone, entrepreneurial attitude often needed in foreign entry.

### Internationalization of Japanese business services

One part of the service industry that has received attention from scholars and researchers is as mentioned the banking and financial sector of Japan. (e.g. Prindl, 1985; Wright & Pauli, 1988; Yoshitomi, 1990; Aggarwal, 1993) The reason for received attention is the rapid increase in importance of the Japanese financial sector in the world economy. In just a few decades the Japanese banks had until the beginning of the 1990s established themselves as major players within the financial system. In connection to this research, studies have been made focusing on the famous Japanese general trading houses, the so-called Sogo shosha. (e.g. Young, 1979; Kunio, 1982; Sarathy, 1985; Dicken, 1998; Mardas et al., 1998) These have attained much attention because of their omnipresence in almost every part of the

world. Often closely connected with a certain Keiretsu group they have for long been an important tool for Japanese companies in their international operations. Studies (Mardas et al., 1998) show that these networks are vital parts for the internationalization of Japanese business. Keiretsu networks seems to be of equal importance for both manufacturing and service operations, and they often follow each other closely abroad. This is supported by the findings of Mardas et al. (1998), by stating:

“Since the early 1990s the Japanese foreign direct investment takes an intensive form in services and especially in trading and financial activities. This evolution in the pattern of the Japanese foreign direct investment is the outcome of the Keiretsu network. The trading companies and the financial firms, members of the groups, follow their partners in Europe, in a process of upward integration of the group presence in Europe. The trading and financial firms use their group partners as market potential as well as source of information and risk minimization”. (Mardas et al., 1998:12)

Chang (1995) shows, based on previous research on the internationalization process, Hymer’s (1976) market development approach, transaction costs etc., that the more intangible resources a firm has got, the more likely are firms to invest abroad. He further shows that Japanese firms move from investing in core competitive advantage areas to areas further away from the main business field. (e.g. Takeuchi, 1992) Finally, Japanese firms engaged in close networks, have a higher possibility to invest abroad. This indicates that the Japanese firms are rather cautious when they are moving abroad. They want to learn from others within the network and they do not want to rapidly move into new areas of business. This shows that Japanese firms want to take care of their Ownership-advantages and then try to internalize them within the company.

Much of the Japanese business success can be found in the fact that Japanese business people have been good students in joint projects. Hamel (1991) shows that Japanese companies very often have a completely different view on co-operation than their

Western counterparts. Hamel investigates the internationalization made through obtaining knowledge or capabilities using various alliances. To join forces is often considered to be a second best alternative, because firms tend to have different opinions on the outcome and the co-operation of the alliance. Additionally, in the case of Japanese-Western alliances, a very complicated cultural factor also exists. In terms of underlying theoretical assumptions the work of Hamel takes its stance in the competitive advantage discussion. (Porter, 1990) This is because knowledge is seen as the most important factor for sustaining competitive advantage. According to Hamel (1991) an alliance consists of intent to learn, transparency to learn and receptivity to learn and partners may have different standpoints for these factors. As the underlying reasons for Japanese firms to take advantage of collaborations, Hamel puts stress on their eager to learn and the ability to win so called micro bargains on the operational level. Ability to learn on the operational level might in a later stage even change the macro situation. This incremental approach may have generated service investments mainly found in the low value added range. The relatively underdeveloped home market in terms of multinational service firms (Porter et al. 2000) may also be a factor behind the lack of investments in high value added services. Because of lack of proper demand, competition, relating industries and a rigid legal and government in the home market, Japan has not been able to foster competitive business services companies. (Ibid.) In turn the incremental approach used, has favored internalization of services among Japanese companies.

Regarding research about the producer services sector in Japan, relatively little research has so far been done by Western researchers. Saxonhouse (1985) and Enderwick (1990) are some of the few researchers who have explored the service

industry in Japan, from a historic and strategic perspective respectively. Of the two, Enderwick (1990) analyses the industry using the comparative and competitive advantage approaches. During the high-growth era in Japan, it was stated that the future lay in the service economy. MITI wanted to promote the change into a society where services such as finance, trade, business services etc. should be valuable parts. Even though effort was put into shifting the Japanese economy, it is obvious that Japan did not manage to catch up with the most developed countries. (OECD, 1999; Porter et al., 2000) Saxonhouse (1985) puts stress on the fact that the service sector in Japan has continuously lagged behind the American and Western European service sectors, in terms on productivity. For example, even though the manufacturing productivity in 1979 had caught up with the Western manufacturing industry, the service sector productivity was only about two thirds of the Western counterparts. It is however important to note that service productivity measurement involves great difficulties. (Illeris, 1996) Additionally, the Japanese service sector was almost closed for foreign competition and strictly regulated, which also generated a weak position of Japan in world trade with services. (Saxonhouse, 1985)

By studying comparative and competitive advantages Enderwick has distinguished three categories of services; highly competitive, moderately competitive and least competitive. With this categorization an attempt has then been made to include various service sub-sectors. Within this set-up, the categories have different features.

**Highly competitive** – Much of the investments abroad have been triggered by the need to follow domestic customers in their internationalization process. Further, the locations have been the ones most familiar to Japanese firms, for example Southeast Asia regarding construction. The internationalization process has also come as a

response to balance of payment surpluses, and within industries with possible economies of scale. Furthermore, the competition, both domestic and international is said to be fierce in this category. Finally the companies in this category have relied heavily on competitive advantage. In this category, companies in banking, finance and construction can be found. **Moderately competitive** – In this category the firms show mainly two common characteristics. Firstly, they display rising competitive advantages on the part of Japanese firms. Here one finds for example engineering consultant firms, insurance companies, advertising, management consultants, transportation etc. Engineering consultant firms try to move abroad with the experience that they have received in Japan regarding high-technology construction projects. Insurance companies on the other hand have mainly served Japanese customers abroad, because of the relative weakness compared with insurance companies in the West. Here, it is stated that, for a true global position of these Japanese service companies, the recycling of trade surplus funds and the reliance on traditional markets in Asia must decrease. **Least competitive** – Within this category there are four common characteristics. Firstly, these service activities are the ones most affected by cultural differences. These are various forms of professional business services such as for example legal services, education, accountancy etc. On the other hand the cultural differences make it hard for competitors to enter the Japanese market. Secondly, these service activities are said to be less efficient than the Western counterparts. Thirdly, these services have not been subject to competition in the domestic marketplace from foreign companies. Finally, these service activities have barriers to trade and competition based on standards, qualifications etc.

## The concept of introvert or extrovert internationalization

The fact that Japan today seems to lag behind in terms of the service economy may however not be as drastic as it looks. Enderwick (1990) indicates the importance of FDI statistics relative to trade statistics. Furthermore, the service sector in general may look bleak and run a deficit, but sub-sectors may be prospering. The most important factor that may generate a gloomier picture than necessary is the high degree of internalization with Japanese companies. The service operations may be there, but kept inside the big companies. The Japanese business environment has not encouraged specialized business services firms. The main reason behind this phenomenon is the lack of stringent strategies. It has been very common in Japan to be everything to everyone, which in the long run deteriorates the competitive advantage. (Porter et al., 2000) These kinds of business practices are especially blocking development in business services. Here, customers demand state of the art services, based on a high knowledge content. A blurred picture creates confusion among potential customers. Add to this, the fact that Japan has experienced a very rigid labor market, in terms of low labor turnover, which has been considered as strength for future service operations. (Enderwick, 1990) This can however also be a big disadvantage, since many successful firms within business services have been start-ups made by professionals (Hermelin, 1997) who have left existing companies. In this respect the crisis in Japan has made the business environment more acceptable towards entrepreneurs and the labor market more flexible. (Field et al., 2000) However, the result is still big companies, industrial conglomerates (Keiretsu) and Sogo shoshas with all the needed service operations in-house. An economy fostering incremental development and lifetime employment within the same company makes trade-offs losing a vital and knowledge-intensive business service sector.

The Sogo shoshas with their many service functions, may also be one factor behind the lack of small- and medium sized business-to-business companies. Their presence has generated an environment favoring internalized business services at the expense of externalized services. Firstly, they are tightly connected and vital part of the Keiretsu system. Secondly, there has at the same time been a strong tradition to supply as many services as possible according to the everything-to-everybody strategy. This has generated at least two repercussions. Manufacturing companies in need of services have been committed to use their Sogo shosha connections within the Keiretsu, if they do not have the needed service internalized. Additionally, possible competitors have been outmaneuvered by the Sogo shoshas due to their multitask strategy.

The results of the above-mentioned factors influencing the development and internationalization of Japanese business services have generated an introvert or extrovert development. The introvert case depends to a large extent on the internalization seen inside companies. Additionally, the cultural factors unfavorable for entrepreneurs are important as well. On the other hand, there is a tendency to be extrovert in the sense that companies try to help each other within the Keiretsu. They use the incremental approach in internationalization and try to leverage resources. This may seem to be a contradiction in terms, but it is necessary to separate internalization-externalization from introvert-extrovert. The internalization within companies is there, but so is also the cooperation between single firms, making the keiretsu-cooperation look similar to what is called network theory in the West. Therefore, it would be possible to say that both introvert and extrovert approaches

exists, not always mutually exclusive. Either way, the environment has been hard for completely independent business services firms.

### Theory cross pooling – extending the OLI paradigm

There are many different theoretical points of departure for the study of business internationalization. The traditional way of studying Japanese internationalization has often been founded in the separate disciplines of internationalization studies, economic geography and management. The complex nature of many service operations, and the fact that it is often hard to distinguish specific reasons for location or internationalization decisions, makes a broader theoretical perspective very much needed. Combined, the theoretical areas generate a solid foundation for moving into empirical testing regarding Japanese business services. Additionally, theory cross pooling is by far nothing new. A successful application can be found in Industrial design (Lorenz, 1986:23) and voices have also been raised within the field of International business stating that much will be learnt if different theoretical approaches are combined. (Porter & Sölvell, 1999; Nachum, 2000)

The research aims at building an extension of the OLI paradigm, which has proven itself to be a useful framework for the study of business internationalization. (i.e. Dunning, 1988, 1998; Brouters, et al., 1999) Drawing on the three corner stones of the OLI approach this piece of research moves on, using theory cross pooling. A possible interpretation of Ownership advantages is that it very much connects to the management conducted within a company. If management takes the correct decisions, the firm can most likely change its O-advantages. The locational aspects expressed through the Locational advantages, can obviously be looked upon as economic

geography considerations. Organization within space makes a difference for company internationalization and locational factors are foundations for development. Finally, the Internalization advantage connects to both economic and behavioral parts of internationalization studies. By using various means of organizing and cooperate in the international business context firms can make use of the concept of internalizing. However, in the case of Japanese business service firms the traditional view of internalizing may be outdated. Instead the concept of introvert or extrovert internationalization is more precise.

The theoretical framework should be considered as a tool to help answering three questions in relation to internationalization. (See Figure 1.) Firstly, internationalization theory, whether it is more economically or behaviorally oriented, will help to understand the process. That is, how do firms internationalize and what incentives or networks are paramount. In this part a distinction is made between economically oriented theories (e.g Markusen, 1989; Hirsch, 1993; Dunning, 1989, 1993) and more behaviorally oriented theories, the so-called network approach. (e.g Johansson & Mattsson, 1989; Håkansson & Johanson, 1992; Anderson et al., 1994; Blankenburg-Holm, 1995; Easton & Håkansson, 1996) Even though a line is said to divide the approaches, (Blankenburg-Holm, 1995), the Japanese case shows that both may exist in parallel. Secondly, economic geography gives a solid understanding regarding where and why investments are made at certain locations. This approach connects with much of the research made within internationalization theory, but broadens the scope through the discussions on clusters, embeddedness, organization within space and national or regional competitiveness. (e.g. Scott, 1988; Porter, 1990, 2000; Dicken, 1991; Daniels, et al. 1993b; Hermelin, 1997; Larsson, 1998). Finally,

the contributions in the field of service management and marketing are needed in order to understand the nature and strategies of internationalized services. Theory cross pooling can, of course be applied in a generic manner, but Japanese business services are a suitable case for several reasons. Firstly, Japanese firms have over the last 40 years experienced a tremendous internationalization process in general. This would give rise to a need for services on the global scale. Secondly, Japanese FDI has been an issue of interest both for private business but also for governments. The result is both geographic implications on the global, regional and local scale, but also intense competition on former solid home markets. Thirdly, the Japanese business culture has been admired for its perfection and efficiency. Many industries have turned to the East for picking up knowledge on JIT, Lean production etc. No implications for the service industry organization, value added or internationalization at all would be astonishing.



**Figure 1: Theory cross pooling**

## Conceptual framework

### *Managing service operations*

Because of the rapid transformation of the economy since the WWII, managing the service economy has become a vital measure for success. Slowly, the business environment created an understanding among academics and practitioners that managing the service economy was something different from the traditional way of looking at business operations. (Grönroos, 1994) It is argued that today's service management is dependent upon an overall management perspective including a holistic organizational approach with a clear market focus. Additionally managing quality and the steady internal development is high priority. The fact that perceived service quality is increasingly important can be seen by the impact of quality measurement. (Fornell et al., 1996; Majkgård & Sharma, 1998b; Anderson & Fornell, 1999) The service economy gives priority to external efficiency and quality perception, instead of overemphasizing internal efficiency, economy of scale and cost focus. (Grönroos, 1994) Furthermore, in business service internationalization, marketing the service at offer and at the same time managing the internationalization process, in an often turbulent environment built on close connections with the customers, can be a difficult task. Attempts have been made studying the internationalization of services by using an integrated approach consisting of management and international marketing. Lehtinen & Välikangas (1994) have tried to establish a framework where they discuss how firms can take on the internationalization by dividing services into generic, specialized and customized. They argue that these different kinds of services need specific approaches in going global. The more tailored the service is, the more is the internationalization process dependent upon narrow segments, networks and local presents. (Ibid.; Sharma, 1991;

Schmenner, 1992; Hermelin, 1997) They also argue that the more customized the service is, more control is needed in the internationalization process, ranging from simple license agreements to subsidiaries following customers abroad. McLaughlin & Fitzimmons (1996) working with the same issues have come up with a matrix in trying to generate strategies in service internationalization. Here they make a distinction of the two main characteristics, globalization factors and global service strategies. Combined they give rise to normative considerations for service firms. However, here the main focus is on the factors and strategies. The most important factors globalizing the service industries are said to be: closer customer contact, customization, complexity, information intensity, cultural adaptation, labor intensity, factors conditions and government actions. These factors are pushing companies to react, using alternative strategies.

In order to best serve its customers, five strategies are put forward. A service company can use multi-country expansion in order to grow, or try to import customers. Additionally, there are strategies such as follow your customer, focus on service unbundling or finally, beating the clock strategy, meaning being global by serving customers over time zones around the clock. This discussion triggers considerations regarding the kind of services that move abroad and how they are managed, and how they should be managed. However, based on cultural differences, there are signs of that these Western influenced internationalization theories are not fully applicable to the Japanese internationalization process and therefore needs extended explanations. (Gerlach, 1992) The complex business environment is one of the more evident features, that makes a comparison difficult. In Japanese economic internationalization locational considerations have been of importance, due to for

example various trade disputes and market attraction. Therefore a discussion regarding the geography of internationalization is in place.

### *Economic geography theory*

International business studies sometimes tend to forget the organization within space. Even though some researchers within the field touch location, (see discussion regarding location in e.g. Dunning, 1988, 1998), there has been few attempts to incorporate theory developed within economic geography. (Porter & Sölvell, 1999; Nachum, 2000) One of the most important underlying reasons for bringing these theoretical considerations into this paper is that economic geography researchers for long have been engaged in studies of Japanese FDI together with the growing impact of service industries in the global economy. (Dicken, 1991; Takeuchi, 1992; Edgington, 1997; Edgington & Hater, 1998) Furthermore the economic geography theory framework generates understanding for both the macro- and industry level, related to the organization in space. Economic geographers early saw the change in development that occurred by the increase of the service sector. Studies have often used a more descriptive and explorative approach than found in for example management and marketing theory. (Marshall, 1988; Daniels, 1993a; Daniel et al., 1993b; Illeris, 1996; Dicken, 1998) This has opened up for a more strategic, and to some extent normative approach, in working with locational dimensions. Here Porter's (1985, 1992) work on competitive advantage has emerged, and widely influenced the study of international competitiveness and internationalization of firms

Studies have been made on the producer services industry, with the purpose of applying or testing Porter's approach. (O'Farrell, 1993; Lindahl & Beyers 1999) have

tried to apply Porter's framework to the producer services industries. In the manufacturing industry Porter speaks of four major strategies, cost leadership, cost focus, differentiation and focused differentiation. Companies trying to elaborate with a mix of strategies often become what Porter calls "stuck in the middle". O'Farrell (1993) and Lindahl & Beyers (1999), however show that this does not have to be the case in producer services. In business services, the differentiation is highly important and costs seem to be of inferior importance. Furthermore, there are no striking differences between firms using one strategy or going with a multiple approach, in terms of business success.

The most valuable theoretical contribution made by economic geographers is the understanding of locational aspects. Here various schools are represented, and it is possible to make categorizations. (see Larsson, 1998 for a thorough discussion) In general, there are points of reference that are more universal. The geographical proximity and the embeddedness of firms within regions endowed with good infrastructure, solid institutional surroundings and possibility for knowledge to flow easily, are aspects of great importance for locational considerations. Again this approach is well formulated in Porter's diamond framework (1992), consisting of: factor conditions, related and supporting industries, firm strategy, structure and rivalry and finally demand conditions. These parts, together with chance and government, work together in explaining and attracting location decisions.

### *Internationalization theory*

The study of company internationalization can mainly be divided in two research approaches, economic theory and behavioral theory. The study of internationalization

from the pure economic viewpoint originates from the classical trade theory based on comparative advantage. Over the years the theories have been developed in order to explain the complex international business environment. Within this framework the transaction cost economics can also be traced. (see e.g. Williamson, 1979; Hennart, 1991) The research has mainly been focusing on the manufacturing sector, but recent attempts have also been made to explain the growing trade and internationalization within the service sector. (see e.g. Hindley & Smith, 1984; Markusen, 1989; Eramilli & Rao, 1993; Hirsch, 1993) Within this discussion it is considered that the comparative based theory is applicable even on international service transactions. Using both economic theory together with transaction cost theory and location theory Dunning (1980, 1988, 1998) has developed the now well-known OLI-paradigm. The most valuable contribution made by Dunning is his ability to combine theories into a useful analytical tool. In his research he has also tried to take the paradigm further and extend it regarding new industries and locational aspects. (Dunning, 1988, 1989, 1998) In parallel, attempts have been made to operationalize parts of the paradigm further, for example to build on the internalization approach, and make more distinct contributions. (Buckley & Casson, 1998)

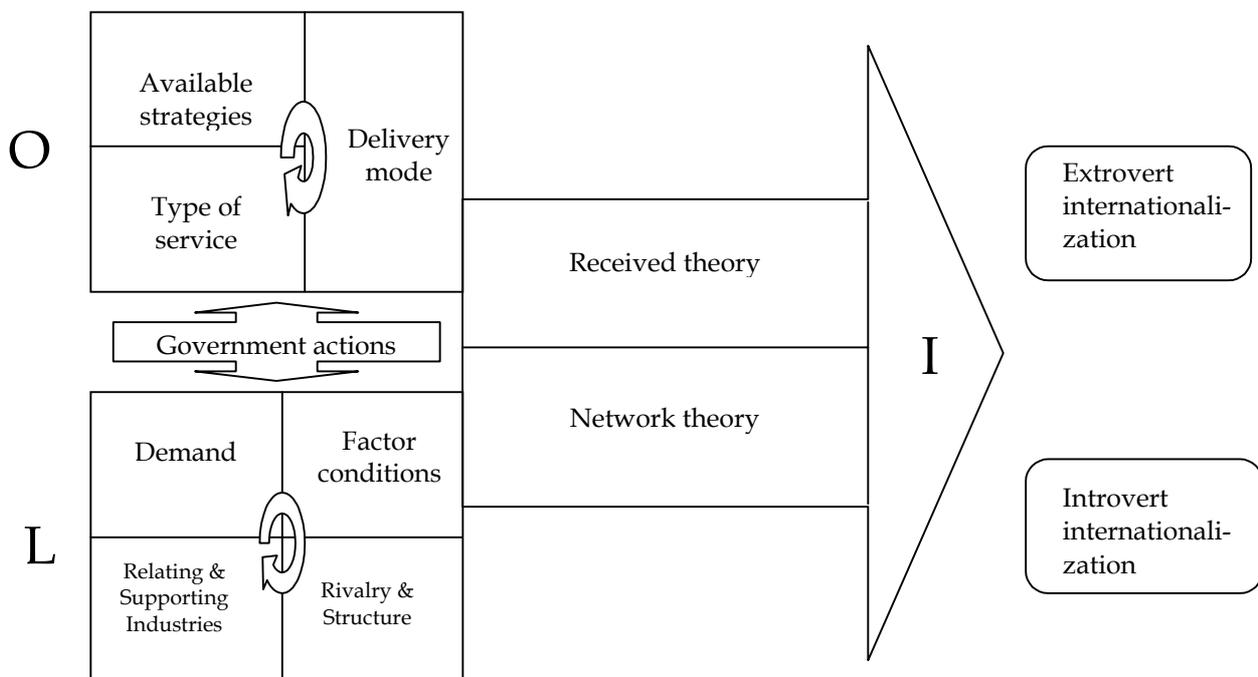
On the other hand, there has been a tradition for internationalization theory to use a more behavioral approach. Here a widespread area of research has been conducted in order to establish common ground for understanding. After decades of analyzing internationalization mainly from the economic viewpoint, (see e.g. Vernon, 1966; Hymer, 1976), the international business research entered a new era with the works of Johansson & Wiedersheim-Paul (1975) and later on Johansson & Vahlne (1977). Since the beginning of the so-called stage-theories based on proximity and psychic

distance and experiential knowledge, a great deal of theoretical development has taken place and the approach has been tested and analyzed by other researchers. (see e.g. Sharma, 1991; Andersen, 1993; Bell, 1995) One basic problem with the stage theory has been said to be the conceptual framework and the relatively modest empirical foundation. (Andersen, 1993) The first studies are only based on few case studies of multinational Swedish manufacturing companies. Recently, however, this research approach has been applied in service industry research and often extended with network theory. (Sharma, 1991; Eriksson & Majkgård 1998; Majkgård & Sharma, 1998a) The findings support the early signs found by Johansson & Vahlne. In parallel with the research on stage internationalization, the network approach has been developed and used in the studies of how firms connect to each other by using activity links, resource links and actor bonds. (Håkansson & Snehota, 1995) A combination of these two theoretical approaches has proved to be a valuable tool for the exploration of firm internationalization. (see e.g. Johansson & Mattsson, 1989; Sharma, 1991; Blankenburg-Holm, 1995; Blankenburg-Holm & Eriksson, 1996; Homin & Tain-Jy, 1998; Blankenburg-Holm & Eriksson & Johansson, 1999) Even though the network approach also mainly has been applied in manufacturing, attempts have also been made to extend the approach to cover the service industry. (Sharma, 1991, Bryson et al., 1993) Because of the tight corporate structure in Japan, woven together into the so-called Keiretsu-groups, (Clark, 1979; Friedman, 1988) the network approach has much to offer. Blankenburg-Holm (1995) has in the research on foreign market entry synthesized the main differences between received theory (economically oriented) and network theory. Interesting counterparts are put forward: strategic decision making vs. process development, unilateral action vs. multilateral interactions, intra firm resource allocation vs. inter organizational resource

dependence and creation and finally normative approach vs. descriptive approach. In the case of internationalization among Japanese business service firms, this classification suits the proposed distinction between introvert or extrovert internationalization. However, in the case of Japanese firms, there is a possibility that they are not mutually exclusive.

### Understanding Japanese internationalization: a revised model

The OLI paradigm and its generic approach towards internationalization generates a solid foundation for exploring Japanese internationalization. Organized in a flowchart, instead of single parts, it can be applied to analyze the internationalization of Japanese business services. (See Figure 2.) This is in line with Dunning (1998) where extensions and further exploration of the paradigm's parts are put forward as



important contributions to the understanding of internationalization.

**Figure 2: Model of the internationalization process of Japanese business services**

Starting with the O-part. To form its most competitive performance, companies must try to adjust and apply different available strategies. It connects to the type of service supplied, but also how they are delivered. Judging on the classification by Lehtinen & Välikangas (1994) and McLaughlin & Fitzimmons (1996), Japanese companies have been pushed out by various globalization factors resulting in strategies for serving customers. Because of the tight corporate structure, cultural dimensions and lack of specialization, the outcome has been very diverse. The lack of stringent strategies hinders the formation of stringent strategies.

Much of the locational aspects can be organized in the diamond framework, Porter (1990). It has a value of explanation in both domestic and foreign markets. The domestic situation forms the wider internationalization path. Here one may question several of the implied parts in the case of Japan. Firstly, the demand of professional business services has been very limited in terms of both value added and extent. Rivalry has been limited because of the Keiretsu structure and the will to use internal competence within companies. A good example is the software industry and the high value added financial services. (Porter et. al, 2000) Important factor conditions such as IT-infrastructure together with specialized education, has been less developed than in the West. Regarding relating industries, with areas of tight company clusters and embeddedness, the company in itself and the Keiretsu have been the alternative. This has not been able to generate incentives for moving into high value added services or specialization. On the foreign side Japanese business service firms have often favored their mother company or Keiretsu. Few, others than financial services have moved abroad on their own. Affiliated company parts or Keiretsu members have in this way

established the demand structure. Motivational rivalry has neither been a factor pulling companies abroad and the fact that value added seems to have been low has not pushed companies out in a search for better factor conditions. Instead incremental alliances in small scale in required industries together with Japanese presence have been driving forces. Relating industries, however, have seemed to be an attracting feature, such as for example in the case of finance-related services in London. In between affecting both O and L are the government actions on both the national and international level. They construct the rules changing both diamond framework and the possible way of serving and foresee the outcome of strategic decisions. Now let us turn to the I-part. For companies there is always a discussion on in-house or out-house. These considerations increase in importance when firms want to establish operations abroad.

In foreign market entry (FME) Blankenburg-Holm (1995) has distinguished between received- and network theory. The network theory is said to better fit the complex environments facing the firm in FME, and can be seen as more dynamic. The network theory often takes its stance in a world with relatively independent companies, based in the West. Therefore it becomes natural to speak about a process development, with multilateral actions, where interorganizational resource dependence and creations takes place. Against this stands the more old fashioned normative approach based on strategies, unilateral actions and mainly intra-firm resource allocation. In the case of Japanese service internationalization however it is possible to conclude that both approaches fit the process and has explanation value. The cultural factor weighs heavily in deciding the Japanese way of organizing global business, together with the complications of the difficult language. Pure rational thinking is not always the reason

for acting, but more often trust, loyalty and long-term relationships. (Clark, 1979; Gerlach, 1992) The outcome is often within what we in the West automatically should call internalization. However, the Japanese way, favoring control has two dimensions; introvert or extrovert internationalization. The introvert perspective describes the pure form of internalization, where all is kept inside the main company. Therefore, it is rare to meet independent business service firms because big firms tend to have as many functions in-house as possible. The received theory is evident. Strategic considerations made through unilateral action and intra-firm allocation fits well the case. The guidelines can be expressed as trust, risk aversion and loyalty.

The extrovert type is the case where the tight corporate structure together with cultural fundamentals such as rigid labor market and skepticism towards entrepreneurs, force companies to use Sogo shoshas or other types of companies within the Keiretsu where everything-to-everyone strategies are evident. This seems to be the second best alternative, after searching for the service within the company. It is extrovert in the sense that the process has much in common with the network theory. It is an internationalization process with an incremental approach, where actors come together in multilateral interactions. They tend to leverage resources within the group and long-term trust is paramount for a lasting relationship. It is only when there is no alternative, that companies go shopping on the market for pure out-house service firms. The lack of stringent strategies, correct locational conditions and entrepreneurial skepticism becomes a vicious circle, blocking a pure rational behavior creating relationships between independent companies in real externalized or outsourced solutions.

Table 2. Characteristics of introvert and extrovert internationalization

<i>Introvert</i>	<i>Extrovert</i>
Trust	Incremental approach
Risk aversion	Leveraging resources
Loalty	Long-term commitment

## Discussion and point of departure for further research

This paper has shown the complex situation of Japanese business services and tried to analyze how the internationalization process takes place. It is clear that the underlying configuration of important parts of the OLI-model and the diamond framework has not been completely present. This has not encouraged the development of a dynamic business service sector with independent companies. The result can be seen in the classification by Enderwick (1990), where relatively few service sectors are competitive on the world market, and if they are, it is in regions or business field tightly connected with the Japanese business sphere in general. The underlying problems together with the fact that strategies have been blurred and not followed the stringent strategies advocated by e.g. Lehtinen & Välikangas (1994) and McLaughlin & Fitzimmons (1996), have made Japanese companies relatively weak on the global market. Instead of choosing one type of service and pursue one clear strategy, the cultural or corporate structures have often favored an everything-to-everyone strategy. The proposed ways of describing the internationalization – introvert and extrovert – has also something to add in the light of how the service economy is described. Grönroos (1994) speaks of external efficiency and quality perception as important in services, opposite to internal efficiency, economy of scale and cost focus, which has tended to be strong areas within Japanese business. (Hamel, 1991) In either case of Japanese internationalization – within the company or the Keiretsu – it is evident that

it will be hard to compete on the global market if decisions are governed by the will to use well-known connections based on a culture generating a multitask strategy, with internal efficiency, economy of scale and cost focus as the main objectives. If the Japanese could develop their more extrovert ideals and expose it to competition as independent companies, the outcome could be as fierce in business services as it has been in manufacturing.

This should be considered a starting point for the study of Japanese business services. An attempt has been made to formalize and to analyze the pattern and underlying factors for internationalization. The most interesting and complex part lies ahead. The next step is to empirically explore the process and its implications for various sectors within business services. A suitable geographical area, would be the UK, where much of the Japanese FDI has been made. There is a need of thorough fieldwork, where the different parts of the model can be uncovered. The next step is to test the assumption of introvert- and extrovert internationalization, and reveal the exact explanation power of the connected expressions. This might be explored through applying the main OLI parts of the model, and more specifically measure: company revenues, to search for a biased decision process, explore the degree of introvert/extrovert demand and consumption and finally measure the supply of services in relation to the misfit of multitask strategy.

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