ARTICLE 7

Chen, S. (2005)

Extending internalization theory: a new perspective on international technology transfer and its generalization

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Explanatory note

Using transaction costs analysis, the author seeks to widen the perspective on technology transfer, to encompass the entire value chain, not simply the final products market. This refines internalization theory, and aids in the understanding of MNE strategy. Whereas it is common to focus on the question of FDI versus licensing, the author considers a broader spectrum of possibilities, by separating out the markets in technology and manufacturing. Co-marketing and OEM (original equipment manufacture) are considered in this more complex context, along with licensing and FDI. The article reminds us of the importance of market institutions in differing business and technology settings.

Some notes on terms

The key concepts used in this article are introduced in the book. They include:

- **Internalization theory** (pp 55 and 358)
- **OEM** (p. 357)
- **Licensing** (pp 44, 240, 291 and 448).

The author refers to **intermediate input markets**, which occur upstream in the supply chain, in contrast to the final products market.

He distinguishes between the MNE and the **indigenous firm**. The latter term simply means a local firm in this context, for example, one which manufactures products using the technology supplied by the MNE. 'Indigenous' should perhaps not be taken literally, meaning a firm with local ownership. Many of the manufacturing companies operating in low-cost countries are owned by outsiders who have built specialist expertise in these activities, as Buckley and Ghauri point out (see Article 6).

A term used by the author which does not appear in the text is the **liability of foreignness** (p. 233). This refers to the fact that the MNE faces disadvantages in the host country, in comparison to the indigenous firm, whose managers are familiar with the environment, culture and business practices.

Chapter link

This article is of relevance to chapters 2, 6, 7, 8 and 12.

Questions

Part A: Grasping key points

1. What is the difference between 'arm's length' and 'contractual' co-marketing? In what situations are they appropriate?
2. In what circumstances is licensing advantageous?
3. What are the benefits of OEM to the MNE and to the indigenous firm?

Part B: Building skills in critical thinking

1. What are the limitations in internalization theory as perceived by the author, and how does this new model overcome them?
2. What is the significance of the three implications for transaction cost economics research highlighted by the author?
3. How does this analysis aid management decision-making for an MNE which owns technology?