Dynamic capabilities for internationalization: from market entry to sustainable internationalization

Abstract

Internationalization process research historically has focused on market entry, without considering the longer term consequences for firms. This paper investigates the dynamic capabilities firms may need for sustainable internationalization. We draw on Teece’s (2007) framework which distinguishes sensing, seizing and reconfiguring dynamic capabilities, and from dynamic capabilities that have been implicit in internationalization process and international entrepreneurship research to identify the dynamic capabilities for internationalization. We study the development of these in a single longitudinal case study of a firm as it developed from being an international new venture to its evolution as a successful international enterprise. We find sensing and seizing capabilities for market entry and for network relationships are most important at early and growth stages of internationalization and reconfiguration capabilities are imperative for sustainability and profitability. Teece’s framework is a useful perspective for extending internationalization process research to consider sustainable internationalization. Managerial relevant research would show managers the dynamic capabilities they need as they internationalize their firms, and help them to develop sustainably and avoid costly mistakes.

Keywords: Internationalization process, international entrepreneurship, dynamic capabilities
Dynamic capabilities for internationalization: from market entry to sustainable internationalization

Introduction

Recent developments in internationalization process research have included focused on issues such as the speed of firms entry into international markets after foundation (e.g. Jones, Covielo & Tang, 2011; Komulainen, Mainela & Tahtinen, 2006; Zahra & George, 2002) and external or internal determinants or drivers of early internationalization behavior (e.g. Knight & Cavusgil, 1996; Bell, 1995). A number of important areas around the phenomenon remain underexplored. First, we know little about what happens after the initial steps in the internationalization process (Zahra & George, 2002), where we have little empirical research to inform us whether early and rapid internationalization does, in fact, lead to long-term survival and success (Kuivalainen, Sundqvist, & Servais, 2007; Wright et al., 2007). Second, despite early advocacy for establishing how smaller firms’ external networks and international value chains evolve over time (Oviatt & McDougall, 1994; Kontinen & Ojala, 2010), little has been done.

Third, internationalization research has focused on the outward processes involved rather than the inward process that has often complemented it in practice (Knudsen and Servais, 2007). Here, for example, while internationalization research recognizes the importance of networks of relationships (Johanson & Vahlne, 2003), it has not addressed how entrepreneurs develop and use them. Fourth, we know little about the international management processes of entrepreneurs and of their firms, and the internal development and changes in the operational modes within these businesses as they grow beyond their initial stages to be able to compete internationally (Kuivalainen & Harris, 2012).

Many of these gaps concern management processes and their evolution over time to become capabilities for achieving long term competitive performance, which has led Kuivalainen and Harris (2012) recently to suggest that the integration of theoretical frameworks from the rich heritage of strategic management research may help (see Verbeke, 2003 and Rugman, 2008), and to propose that the resource based view of the firm’s development into the knowledge-based and dynamic capability perspectives may be of particular value (see e.g. Teece, Pisano & Schuen, 1997; Teece, 2007; Weerawardena, Mort, Leisch & Knight, 2007). Here we adopt a dynamic capabilities perspective to develop a theoretical framework for examining internationalization as a sustainable process, rather than
as a time-limited event. For Teece et al. (1997), dynamic capabilities are the underlying capabilities that are essential for success in the dynamic global environment:

Winners in the global marketplace have been firms that can demonstrate timely responsiveness and rapid and flexible product innovation, coupled with the management capability to effectively coordinate and redeploy internal and external competences. [p. 515]

The ‘capabilities’ are the strategic ones to ensure ‘that the firm has the appropriate level and organization of ‘internal and external organizational skills, resources and functional competences to match the requirements of a changing external environment’ (p. 515). ‘Dynamic’ refers to the capacity to renew these competences to deal with changes. The dynamic capabilities for internationalization however, need to accommodate changes not only in the external world (which is Teece et al.’s concern) but also changes that are consequential to the firm’s decisions and actions to internationalize. We ask how these differ as a firm’s internationalization progresses from initial internationalization to competing effectively as an international firm.

We study the process of internationalization of a manufacturing firm which successfully holds a niche segment in the world consumer electronics industry. We study in detail the challenges the managers faced, and examined what the managers were doing as their firm developed, why, and how. We follow Coviello (2006) by adapting Kazanjian’s (1988) growth stage categorization, and at each stage of internationalization, identify the capabilities they needed, and how they acquired them.

We find these capabilities to change profoundly as the firm internationalized. Sensing and seizing knowledge for market entry and of network relationships are the most important capabilities at early stages of internationalization, but as the firm develops, grows and matures, international reconfiguration capabilities become more important if the firm is to achieve sustainable internationalization. The paper proceeds as follows: we first present the theoretical foundations, outlined above, and conclude by describing a research framework that informs the study. We then outline the method of research before presenting the findings and analysis, which we discuss. We present a descriptive model that presents the dynamic capability that firms require at different stages of internationalization before drawing conclusions and implications for managers and future research.
Dynamic Capabilities and Sustainable Internationalization

Internationalization process research over the past 30 years has informed us greatly about initial internationalization, but we know little about the international management processes nor the internal development and changes within internationalizing firms as they grow to become multinational enterprises, factors that, a priori, would appear to be central to their sustainability. It has now been proposed that internationalization research should address the forms, strategies and operations of internationalizing firms as well as their evolution (Jones, Coviello, & Tang, 2011; Zettinig & Benson-Rea, 2008).

The resource based and knowledge-based view views of the firm have been employed widely in internationalization research, and while this acknowledges the importance of capabilities and resources, we little about how the entrepreneurs develop or acquire them, where they come from, and how they change as the firm grows. It is here that the resource based view’s integration with the organizational learning concepts into the dynamic capability perspective may be of particular value (see for example Teece et al., 1997; Teece, 2007; Weerawardena, Sullivan Mort, Liesch, and Knight, 2007).

Research into the processes that firms undertake to achieve international growth supports the idea that internationalization performance depends on sets of dynamic capabilities. For example, by integrating organizational learning with internationalization theory, Weerawardena et al. (2007) propose that firms need internal, marketing and market-focused learning, and networking capabilities. Some empirical variance studies have identified organizational characteristics that can be associated with better internationalization performance; Sapienza, Autio, George, and Zahra (2006) suggest that organization age, managerial experience and resource fungibility bring advantages that enhance sustainable successful internationalization. Little research, however, has sought to identify, specifically, the particular dynamic capabilities that underpin internationalization (Cui, Griffith and Cavusgil, 2005; Yalcinkaya, Calantone and Griffith, 2007).

Theoretical foundations

Developing from Teece et al.’s (1997) and Teece’s (2007) definitions of dynamic capabilities, we can regard dynamic capabilities for internationalization to be the dynamic changes that the firm needs to make to adjust both to the changing external environment and to the changing context of the firm that have been occasioned by the firms’ own decisions and actions to internationalize. We now draw on Teece’s (2007) deconstruction of the dynamic
capabilities concept, represented in the framework shown in figure 1, to identify what the dynamic capabilities for internationalization might be, according to Teece’s (2007) definition, from extant internationalization process and international entrepreneurship research.

Teece’s capabilities of sensing and seizing reflect notions from the earliest strategic management research (Ansoff, 1965; Andrews, 1971). These are reflected in the strategic need for firms to identify and interpret relevant factors and trends within the environment within which they are operating, which is reflected in the notion of sensing. Teece’s notion of seizing also reflects strategy’s primacy on strategic action, in order to achieve appropriate ‘fit’ between the internal operations and organization of the firm and the way that it is choosing to compete, and the external environment.

Teece’s third notion, of reconfiguration, reflects not only early observations of the need for firms radically to change themselves (e.g. Chandler, 2005), that became reflected in the strategic planning approach, but also the strategy process approach that reflects ideas of organizational learning and change (e.g, Mintzberg & Waters, 1985; Pettigrew, 1987). In innovative contexts especially, emergent or learned strategy formation enables flexibility, adaptability and dynamism that the planned approach inhibits (Mintzberg & Waters, 1985, Quinn, 1985), while resource-based strategies recognize intangible, especially knowledge resources that are more relevant in contexts where the future is highly uncertain (Grant, 1991; Wernerfelt, 1984). Reconfiguration capabilities therefore reflect an ability to change the structure, organization and decision making, including strategy formation processes (Mintzberg & Waters, 1985). Being able to reconfigure starts with an ability to sense the organizational contextual needs and to capture resources necessary for fundamental change, but then requires an ability to destroy existing organizational structures and routines in order to build new ones (Teece, 2007).

![Figure 1. Teece’s three types of dynamic capabilities (Teece, 2007)](image_url)
Armed with Teece’s conceptual framework, we review internationalization process (including international entrepreneurship) research to identify important dynamic capabilities for the internationalization process. We identify these as the dynamic capability to sense and seize knowledge for market entry (e.g. Johanson & Vahlne, 1977); the dynamic capability to sense and seize network relationships for internationalization (e.g. Johanson & Mattson, 1988), and the dynamic capability for international strategic reconfiguration (e.g. Forsgren & Johanson, 1975; Freeman & Cavusgil, 2007). These are now considered in turn.

The dynamic capability to sense and seize knowledge for market entry

The problems that can lead a firm’s market entry to falter or fail can be associated with host market or international market conditions, and the result of deficient capability to meet the needs of new customers (Javalgi, Deligonul, Dixit & Cavusgil, 2011; Welsh & Welsh, 2009; Zahra, Ireland, and Hitt, 2000). Johanson and Vahlne (1977) identified lack of tacit market knowledge to be the main obstacle to international operations (p.23) and its acquisition requires experience of operating in the market (Johanson & Vahlne, 1990; Fletcher & Harris, 2012). So this tacit experiential market knowledge is a rare and valuable resource (Barney, 1991) that is essential for entry into international markets. The process of learning in the Uppsala internationalization process is provoked when problems are encountered when entering new markets (Fosgren, 2002). Sustainable internationalization requires exploration and exploitation skills for acquiring, absorbing and integrating, and using this knowledge (Yalcinkaya et al., 2007).

Even if the knowledge involved (to some extent at least) is acquirable in ways other than direct experience (Fosgren, 2002), the capabilities required “typically must be built because they cannot be bought” (Teece et al., 1997, p.517). As these are difficult and time consuming to acquire, they represent sources of sustainable competitive market-entry advantage (Barney, 1991). We can therefore see how, from the earliest origins of internationalization process research, the capability to learn about the market and to use this knowledge effectively has been identified, albeit implicitly, as an important dynamic capability for internationalization.

The dynamic capability to sense and seize network relationships for internationalization

The fundamental role of relationships has been highlighted in internationalization process research from its earliest days (Johanson & Mattson, 1988; 1992; Johanson & Vahlne, 1990; 2003). Networks, and relationships developed from within networks, present valuable nationally specific intangible resources that help firms to internationalize (Coviello & Munro,
1995, 1997; Madsen and Servais, 1997). Firms can compensate for resource limitations (Johanson & Mattsson, 1988) by learning “how to build new business networks and connect them to each other” (Johanson & Vahlne, 2003, p. 93). The importance of networks has been supported by research adopting the relationship perspective (Dyer & Singh, 1998), the network perspective (Granovetter, 1985, Larson & Starr, 1993) and the international entrepreneurship perspective (Coviello, 2006; Komulainen, Mainela & Tahtinen, 2006; Oviatt & McDougall, 2005).

Since relationships are important resources for undertaking internationalization, the ability to explore, develop, maintain and exploit them represents an important dynamic capability for sustaining an internationalization process (Freeman & Cavusgil, 2007; Freeman, Hutchings, Lazaris & Zyngier, 2010; Nordman & Melen, 2008). It is important for firms to manage this proactively (Ghauri, Tarnovskaya & Elg, 2008; Johanson & Mattsson, 1988; Kontinen & Ojala, 2011 Freeman et al., 2010) or they will face a danger of ‘network rigidity’, in which they become locked into existing relationships (Mort & Weerawardena, 2006). Further, while partnerships are essential to give access to local knowledge and marketing capabilities (Chetty & Campbell-Hunt, 2004; Freeman, Edwards & Schroder, 2006), this can be a costly exercise, and many relationships may not add value and some may impair internationalization (Coviello & Munro, 1997; Mort & Weerawardena, 2006; Sasi & Arenius, 2008). The dynamic capability to build relationships develops with experience. Established relationships and networks help new ones to be found (Freeman et al., 2010; Gulati, 1999), and knowledge of how to network and form and use relationships builds, over time, in the activity of internationalization (Johanson & Vahlne, 2003; Mort & Weerawardena 2006).

The dynamic capability for reconfiguration for strategic change

For Teece et al. (1997), dynamic capabilities are “the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments” (p. 516). The dynamic capabilities outlined for knowledge and relationships, outlined above, will be necessary but insufficient to achieve this for internationalization. Since dynamic capabilities are to identify and to respond to opportunities (Eisenhardt & Martin), exploitation of assets and capabilities are closely linked with their exploration (March, 1991; Rothaermel & Deeds, 2004). This requires the strategic management capability continuously to adjust, develop, coordinate and redeploy resources and capabilities effectively to gain and sustain competitive advantage within the unique but changing characteristics of the marketplace.
Effective internationalization also requires the capability to act strategically in host countries, as was reflected in the establishment chain intrinsic to the original Uppsala model, under which the migration of functions to developing foreign operations ultimately included at least some strategic decision making at local level (Forsgren & Johanson, 1975, Johanson & Vahlne, 1977). The role of strategy formation within new territories has been affirmed in subsequent studies of developing multinational enterprises (see Birkinshaw & Hood, 1998; Holm & Pedersen, 2000).

Some researchers have portrayed the application of the collective knowledge, skills and resources of the firm to the market-related needs of the business in new territories as marketing capability (Day, 1994). Customizing products, adapting to customers, and being able to effectively and rapidly access and penetrate multiple markets suggests superior marketing capabilities (Cavusgil & Zou, 1994). Others have portrayed the innovativeness this requires, and the ability proactively to seek and recognise opportunities, develop the organisation through capabilities reconfiguration, mobilise resources and develop and reconfigure dynamic capabilities in changing business environments for firm performance to represent entrepreneurial capabilities (Lumpkin and Dess, 1996; Madsen and Servais, 1997; Weerawardena et al., 2007).

These capabilities (figure 2) reside within the managers driving the internationalization process (Freeman and Cavusgil, 2007; Weerawardena et al., 2007). Freeman and Cavusgil (2007) characterize strategic internationalizing managers: they are committed to international performance, adaptable and innovative in how they do it, highly strategic in orientation and proactively develop and use personal and organization-centered contacts. For example, they may start with a special project to begin searching for partners in the lead markets, and use these to help form strategic alliances in lead markets in an innovative, proactive, and risk taking way. This strategic capability develops dynamically: the act of adjustment when internationalizing can encourage the development of new organizational capabilities for achieving sustainable competitive advantages internationally (Keil, Autio, and George, 2008; Zahra et al., 2000).
Having integrated Teece’s (2007) conceptual development of dynamic capabilities with the capabilities needed for internationalization identified from previous internationalization process research, we have developed a framework of dynamic capabilities for internationalization shown in Figure 2. The body of theory on which ideas concerning these dynamic capabilities have been built is substantial, but these have not been applied within internationalizing firms. Our research questions for this study are; why are dynamic capabilities needed to sustain internationalization, what are these dynamic capabilities for internationalization, and how these dynamic capability needs change at different stages in the internationalization process?

**Methodology**

We employed a longitudinal single case study research approach examining dynamic capabilities in an internationalizing firm, Linn Products, over a considerable number of years. We had access to and were informed by the individuals who were managing that internationalization. This approach is appropriate when studying dynamic capabilities for three reasons. First, we were able to access fine-grained data from a relevant firm and individuals over a period of internationalization that would enable us to draw theoretical generalizations but remain sensitive to the context and perspective and the actors involved (Eisenhardt & Graebner, 2007; Miles and Huberman, 1994; Welch, Piekkari, Plakoyannaki, & Paavilainen-Mäntymäki, 2011).

Second, we had begun with some strong theoretical concepts but these had not been previously investigated empirically within international firms (Eisenhardt & Graebner, 2007; Ghauri & Gronhaug, 2010; Yin, 2009). Third, we sought to identify the sequence of needs for dynamic capabilities for internationalization over time, combining real-time and retrospective
data collection methods (Leonard-Barton, 1990). From 2000 to 2011, we accessed the views of key individuals within the company, its advisors, consultants and archival data, as events unfolded. This avoided ex-post rationalization over this period (Van de Ven & Poole, 1990). In order to extend the analysis of dynamic capabilities needed from the firm's inception to 1999, perspectives were gained from the multiple key informants during the data collection. We now summarize the research procedure in this study.

Identification and purposeful sampling of a case

We used secondary and archival data from a government program including company profile, reports and financial data, to select a single case firm using purposeful sampling as described by Miles and Huberman (1994) and Patton (2002). We chose to study Linn Products, a high quality hi-fi manufacturer launched in 1972 by an engineer entrepreneur, that was targeting the high end of the market (Brassington & Pettitt, 2006:939). The business had been international from inception, and joined an internationalization program in 2000 to help grow the business internationally, thus fits the purposes of the research. This case provides the potential to reveal theoretical reasoning, through an intense description of the existence of a phenomenon (Siggelkow, 2007).

There can be different rationales for selecting a single case. Yin (2009) identifies the revelatory case; following Ghauri and Grønhaug (2010) we note:

"A single case design is appropriate when a case is revelatory. This means that we can observe and study a phenomenon that was previously not accessible and which can provide useful insights." [p.114]

The Linn Products case had the capability to provide theoretical insights that could clarify and broaden the links and logic between the dynamic capabilities and the internationalization process constructs (Yin, 2009). Ensuring deep and broad access to specific individuals within the firm was critical if the study were to reveal the factors that influenced the firm’s internationalization. Linn Products was chosen because it had sustained internationalization over periods of dynamic and global industrial change and offered research access with richness of data that could reveal managerial factors with regards to the theoretical constructs of dynamic capabilities and internationalization.

We used the growth stage categorization offered by Kazanjian (1988) to assess the dynamic capability needs at different stages. Stage I (conception and development: resource acquisition and technology development) was not relevant to our study as it did not concern internationalization. We begin the study in 1972 when Linn was in Stage II, concerned with commercialization of the business, which involved production start-up and international
market entry. From 1989 to 1999, the firm built production capacity to serve international markets. From 2000 to 2005, we follow the firm closely as it built international sales and organization development to enter stage III, when it internationalized substantially. From 2006, when their sales and profits faltered after periods of high growth, it progressed into and through Kazanjian’s Stage IV that involved the organization of international operations to achieve stability, profitability, control and future growth base. Linn’s sales from their internationalization growth and stages are present in figure 3.

<table>
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<tr>
<th>Year</th>
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<td>Sales</td>
<td>£19.5m</td>
<td>£27m</td>
<td>£36m</td>
<td>£35m</td>
<td>£42m</td>
<td>£38m</td>
<td>£32m</td>
<td>£33m</td>
<td>£23m</td>
<td>£12m</td>
<td>£16m</td>
<td>£17m</td>
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Figure 3: Linn Sales 1999-2010

Data Collection and the Interview Process

A case protocol was employed in the data collection process to enhance the reliability of the research (Yin, 2009). Data collection procedures were standardized within the research design to achieve equivalence and comparability between the constructs (Sinkovics, Penz & Ghauri, 2008). Following Linclon and Gupa (1985) the research design sought to establish trustworthiness and validity in the findings through prolonged engagement and triangulation. In order to triangulate the data, we used multiple sources of evidence; company interviews, advisors and archival data. A list of the main data collection sources is detailed in Appendix A.

Interviews are an effective approach for collecting rich, empirical data, especially when the phenomenon of interest is ‘episodic and infrequent’ (Eisenhardt & Graebner, 2007: 28). Semi-structured interviews, lasting from 60 minutes to 90 minutes, were undertaken with top and senior managers within different units in the firm, most were conducted at the firm’s head quarters. Note taking was allowed during all the interviews and were also digitally recorded and subsequently transcribed for detailed analysis. Some of the interviews were repeated and others were followed-up informally with both e-mails and telephone calls in order to achieve data confirmation (Ghauri & Gronhaug, 2010; Yin, 2009). The managing, finance and marketing directors were interviewed each year during 2003, 2004 and 2005 as they implemented an international growth plan. In these interviews, data was collected on the firm’s past and present internationalization activities and challenges, and how issues arising from these were addressed.
The research questions generated a list of questions on specific areas, but the protocol allowed interviewees to elaborate and answer questions flexibly, enabling the interviewers to obtain rich and detailed responses. From 2006 to 2011 the company was monitored by accessing press reports and publications, which suggested that the firm had undergone further periods of change in response to internationalization challenges. In 2011 access was secured again and a further series of interviews were carried out with the CEO, R&D, manufacturing and sales directors. The interview schedule was developed from the research questions, so the form and content of interview protocol was stimulated by previous theory in the area. Perry (1998) indicates that there are concerns that imposing specific question-types influences the interviewees’ responses.

Since the concepts that we are working with have been the subject of considerable theoretical development in the past there was a danger of confirmatory evidence bias (Sharpe, 2004). This was averted both by the extent of triangulation and by designing an interview schedule that would explore and unravel the issues and the thinking of the interviewees themselves in as non-directive a way as possible to achieve free flow answer and discussion (Harris, 2000; Yin, 2009). The questions remained open for refinement during the process of collection of empirical study, which helped to achieve consistency between the data collected and the research questions (Harris, 2000).

From 2000, the company participated in a government internationalization program, enabling extensive archival data to be accessed that included; a company profile prepare by the program managers, independent consultants’ report and company history, minutes of meetings with the firm and their consultants and advisor, the firm’s internationalization growth plan, financial data, and media data reports. In addition, interviews and meetings were held regularly with company’s advisors to monitor the firm’s development. This wide triangulation generated corroborative evidence that improved validity and credibility (Lincoln & Guba, 1985; Yin, 2009).

Qualitative data analysis

Data collection and analysis were interrelated processes that involved inductive and deductive reasoning (Strauss & Corbin, 1998). This was an iterative and comparative process between existing theory and the data, which was conducted continuously and repetitively throughout the study (Yanow, 2004; Yin, 2009). Data coding involved a process of conceptualizing, reducing, elaborating and relating of data (Strauss & Corbin, 1998). Initial
coding was driven by our research questions to analyst company interviews. Broad categories were then constructed from pre-existing internationalization process and dynamic capabilities literature as well as from our data. Identification of associations amongst categories involved continuous interplay between researcher and data in order to develop an organized and interpreted ‘theoretical explanatory scheme’ (Strauss & Corbin, 1998: 11). The management of the data, the systematic and standardized classification of codes was aided by the use of the Nvivo qualitative data analysis software (Sinkovics et al., 2008). The last phase of the research procedure involved overall data analysis and re-evaluation of the data collected, considering, accounting for, and interpreting all the collected data prior to finalizing the study findings (Miles & Huberman, 1994).

**Findings: The Dynamic Capabilities for Market Entry and Development**

The findings are now presented whereby three sets of dynamic capabilities are identified and are discussed within Kazanjian’s (1988) growth stage framework.

**Stage II, Commercialization: production & start-up**

For commercialization stage, Linn needed to develop capabilities to enable initial market entry. The first overseas market entries were into Japan and then into the USA, these selected as being the key markets in the world Hi-Fidelity industry. A critical capability that was needed for seizing the opportunity opened up by the firm’s technological developments was that of being able to find and secure the right distributors in the markets. As a new firm, it had to attract the right partners, and to sell their products to them. For Linn, this was a trial and error process that involved the CEO assessing the distributors’ performance, and then replacing the distributors when they were not a successful choice:

> The founding CEO went to Japan very regularly for years and years building relationships, making demonstrations, persuading people, demonstrating the product, that we had a great superior product. And so that was the blueprint for how we would break into a new market. When entering the market we had to find a new distributor, but it was quite common that the first distributor was not always the right distributor, very often it then went to a new distributor. [CEO]

Through this method, the firm achieved international sales growth and further market entries.

**Stage III, Growth: sales growth and organizational development**

In the growth phase, Linn continued to develop its retailer and distributor networks in new international territories. But problems with distributors remained, in the USA and now also in Germany. It found that it did not have the level of control over its distributors in these markets that it felt it needed, and the level that it had in other countries, and this led to disagreements with the distributors there. As a result, Linn began to develop its subsidiary operations in the
USA and Germany in order to establish its own direct overseas sales operations in these territories:

Once the business became established, then you focus more on the kind of (sales) partner you need, rather than establishing yourself in a market. So for example, we’d been established in the United States for a long time, but the way that we sold in the United States has changed dramatically depending on what stage the business is at. [CEO]

Problems then developed, however, with the management of its subsidiaries. Linn initially sent headquarters staff, but then had difficulty finding the right people to manage them locally; it lacked the capabilities for managing overseas subsidiaries. It needed to learn about management structure and control, and needed to learn the skills, structures and processes for being able to acquire information from subsidiaries about overseas sales performance.

Recognizing this need, Linn recruited consultants to develop and install systems for monitoring sales performance, and instituted a sales training program for supporting overseas sales staff and agents. Sales growth was high between 2000 and 2005, but profits fell and the company went into loss; the firm had not resolved its difficulties in running subsidiaries, and concluded that it did not have the capability for doing so. It closed its subsidiaries in Germany and the USA and went back to using retailers and distributors in these territories. Nevertheless, when developing its operations in Japan, Linn had learnt from its experience, and its mistakes in managing distributors, and the outcome was a successful use of distributors:

We had our own distributors in the US and Germany. We were just rubbish in tackling all the problems, it’s easy on paper but in reality but actually we got really good people but they developed their own bad habits and practices and there was just an absolute horror of mistakes and it takes a long time to put it right. We have brought everything back in here and we feel at this stage we can actually be global, think Glasgow without having to have offices in New York, London …….. I think for us the big challenge was developing good business practice - take our Japanese distributors in Japan, we’ve worked with these guys for over 20 years and nobody thought we could never sell in Japan because of the cultural barriers, etc but we’re getting the right people, after we made mistakes in America, I think we got better. [Manufacturing director]

Stage IV, Stability: profitability, control, and the future growth base

In response to falling global sales and increasing losses, Linn retracted into profitable market segments. The firm has developed new capabilities in each of the areas where it previously failed, for example in local management and market information systems, in management procedures, and in distribution and retail networks.

The senior management has learned how to understand new markets, and to approach them appropriately. At the same time, they have recognized that there are different conditions in different overseas markets, and past experience has taught them to apply varying approaches
in the US, in Europe and in Japanese and other Asian markets. The trend in Europe, for example, is towards direct business and away from distribution, as the firm had grown they have found it easier to directly in Europe, avoiding the need for distributors. The trend in East Asia is towards distribution, but a sole distributor model not viable in Japanese or East Asian market conditions, where they now use multi distributors. This experience and learning has resulted in success; the firm achieved stability and returned to profitability in 2010:

Because as Europe and the West declines, we need to build more business in Asia, the trend in Europe is towards direct business and away from distribution, the trend in Asia is towards distribution. And we now have distributed in places like Thailand, Vietnam, Indonesia, Korea, Taiwan, Malaysia, Singapore, in all these places we now have business partners. [CEO]

The result was not only a return to profits, but higher profits and a more secure and stable position and future outlook than ever before. Having recognized that their entry to the US and Germany was failing, the management team learned from that experience, and as a result, Linn’s entry into new territories has been more successful. Sales have grown considerably in new territories, especially in Asia.

Findings: The Dynamic Capabilities for Networking

Stage II, Commercialization: production & start-up

Linn needed a capability to find and work effectively with partners to become an international firm. This involved the two key aspects: first, selecting and working with distributors (linked to market entry and development as discussed above), but second, the ability to manage the international manufacturing supply chain and to manage outsourcing. In order to commercialize their products, Linn needed to find suppliers of electronic components and other inputs. The firm’s response to scaling up production and output was to outsource extensively much of the component manufacturing to overseas suppliers, but this created problems in maintaining quality of components and reliability from suppliers. This was critical because the firm’s products were positioned at the premium end of the high fidelity market, where high quality was an important consideration. Furthermore, outsourcing resulted in a loss in flexibility in manufacturing, which had been a key strength.

I juggled with trying to obtain the best cost price ratio for the company (from suppliers), from a business perspective. and managing the expectations and the quality requirements of my colleagues on the other side, who are trying to specify the absolutely best thing for the product. [Manufacturing director]
Stage III, Growth: sales growth and organizational development

As a result of the problems experienced from outsourcing, Linn sought more reliable and flexible suppliers, and developed a strategy of building long term, close relations with local smaller manufacturers to ensure quality and quantity of supplies. The emphasis was now more towards flexibility, design and reliability, rather than on sourcing components at a low unit cost.

The whole business cost sometimes actually tells you that it’s much easier dealing with a company with a higher unit cost. They are sometimes much more willing to have flexibility with you. They are typically a bit more flexible because they are dealing with companies the same size that they are. You might find that the local suppliers has a similar mind set to us in terms of how we deal with business, with life, what their goals are. It’s not like dealing with a massive supplier anywhere in the world; American, Chinese or Brazilian, because they are at the lowest cost point. [Manufacturing director]

We have become more concentrated on the home region when we’re looking to source any component for a product, and that’s either during the introduction period, but even when we were back in the research period, where we still so many years away from the product. We are thinking, you know, is it the right component, how much is it, where is it from, what price is it, what will support be like in 5 years’ time. [Manufacturing director]

As the company focused on sales growth, it outsourced more of its production. Although their R&D was initially in-house, they also outsourced the design function and cut most of the design staff within the R&D department. This, however, resulted in loss of flexibility and problems with reliability.

It is a little bit about control and fear. … Our history, our experience of outsourcing anything, it has never been good. Either from a flexibility perspective, from the outsourced research or design capability, from a reliability perspective, or from the future scalability perspective. You may get the design that you want, you may get it for the cost you wanted, you may get it with the reliability you wanted, but when you come a year later and you say, I’d like to do this offshoot or do this plus one product, this plus two product, that scalability has never been built in, which is something that we do here. We’ve found that the outsourced research company is not flexible enough. They are not available at a time that you need them and you want to go back to them to do some work. The bit of design that they did might be the most unreliable thing in the product. [R&D director]

Stage IV, Stability: profitability, control, and the future growth base

As Linn began a process of consolidation, in order to avoid further outsourcing problems, it reversed the strategy of outsourcing R&D and manufacturing, and brought work in-house as much a possible. The greater flexibility that resulted enabled Linn completely to change its manufacturing process. Here, manufacturing was transformed by instituting a new production planning process that drove manufacturing according to sales orders.

We want to have more control of component parts and processes. that was a huge influence in the selection of technology. Scottish enterprise, helped fund a huge piece of internal technology development that broke our dependency on a huge amount of Far Eastern and Silicon Valley based technology. And so there was a huge step in consolidation. We dropped all of that technology at that point, it all had to come from overseas. Now all the work we do with streaming technology is all in house, so there’s a massive difference to the company [CEO]
Findings: The Dynamic Capabilities for Strategic Change

Stage II, Commercialization: production & start-up

In stage II, Linn did not have to consider reconfiguration, and even in hindsight, the managers do not think that they should have been considering it.

Stage III, Growth: sales growth and organizational development

The need to change the way the firm operated became important during phases III and IV. During stage III the management team saw the need to become more market oriented, and to move away from a product and production focus that it had inherited from its previous stage of growth. The need of the firm was to reconfigure its activities in order to support internationalization, to improve overseas sales processes, to institute new product development that was market focused, and to manage overseas operations.

Linn created systems to support overseas sales managers, distributors and direct sale forces and to closely monitor their performance. A new product management system was also created that helped to create a market focus within then firm, which included systems that fed overseas market information into products being developed and manufactured. A new director was recruited from outside the firm as part of a process of moving it from being a technology and production based firm to being a marketing focused firm. By improving the linkages between marketing and R&D, since 2005 new product development was more related to customer needs.

"The new team/function has become the source of that expertise and then by gathering all the input and information and becoming a reference point then they become the real expert for what our customers are likely to require and what we can deliver". Managing Director

To support the new customer focus, it became necessary for Linn’s subsidiaries within the different main territories to develop strategies, and not to leave all that responsibility to headquarters. To support the overseas subsidiary operations in developing the capability to undertake strategy development, however, support was needed. Linn invested in extensive management training to develop top managers and increase delegation to middle managers, this involving both headquarters and subsidiaries..

The structural changes have flowed through from the early discussions with our internationalization advisors about how we should structure the business. We have a new executive management team .. to develop our managers in the business and all our people, but it is the managers primarily in terms of achieving their line of vision, and leadership, we have introduced quite specific leadership development. [Managing Director]

We have introduced a managerial line across the business now which is basically about focus and clarity and taking responsibility and implementation. [Marketing Director]
Stage IV, Stability: profitability, control, and the future growth base

Linn continued to grow but made losses in 2005, and during 2007, sales dropped significantly. The pressure was now to survive, and the need was to consolidate, to achieve. The management team realized that they did not have sufficient capabilities as international distributors/retailers, nor the management capabilities to run the company on an international basis, as became most manifested in their continued failings in the United States.

The firm had developed the capability to strategize locally, but Linn not only needed now to also embrace local market strategic choices and decisions, but also needed to be able to develop an overall multinational international strategy that was flexible for changing international as well as local conditions. The diagnosis was that, in short, Linn did not have the necessary management and management systems to operate as a coordinated, sustainable international business.

The problems were manifested in sales and marketing information and in management and leadership at HQ and subsidiary levels. Linn closed the US and German subsidiaries, and now use independent retailers in those territories. Having learned from the mistakes made in USA and Germany and have internationalized into Asia with better strategies. When expanding in Asia, Linn has developed its management capabilities first, before growing there, and in Japan and East Asia are successfully using a locally developed strategy of using multi-distributors. Expansion in East Asia is highly profitable, and with sustainable success now evident in Japan, Linn has now returned to overall profitability, and the next growth focus will be in Asia.

Discussion

This qualitative enquiry is based on a single case study of a firm that was actively internationalizing as a strategy for growth (Zahra, 2005), so the generalization possible from the findings is necessarily limited to theory concerning sustainable internationalization, rather than to firms in general. This revelatory case shows how a firm has developed dynamic capabilities that have enabled it to compete successfully and sustain a presence in the international market place (Ghauri and Gronhaug, 2010). The study set out to examine in detail why dynamic capabilities are needed for sustainable internationalization, what these dynamic capabilities are, and how these dynamic capability needs change at different stages of the internationalization process. These are now considered in turn.
The need for dynamic capabilities is identified from failings

It is the recognition that while knowledge, skills, networks and relationships are fundamentally important (Peteraf, 1993; Collis & Montgomery, 1995), the observation that creativity and innovation also lie at the root of gaining and sustaining competitive advantage worldwide (Meuleman et al., 2009) presents the theoretical foundation for a need for dynamic capabilities. Dynamic capabilities associated with the ability to learn and adapt enable resources to be transformed into sustainable competitive advantages for emerging and international markets (Newbert, 2008; Peng et al., 2008), so that they can profitably enter emergent markets (King & Tucci, 2002), tie up industry relations (Dyer & Hatch, 2006) and restructure underperforming resources (Galunic & Eisenhardt, 2001). In unpredictable environments, dynamic capabilities also enable existing resources to be recombined into new sources of firm value (Eisenhardt & Martin, 2000). Peteraf, 1993; Collis & Montgomery, 1995 Meuleman, Amess, Wright, & Scholes, 2009 Newbert, 2008; Peng, Wang, & Jiang, 2008; King & Tucci, 2002; Dyer & Hatch, 2006)

Linn felt these needs in the form of observed and recognized organizational failings. In the early stage of internationalization, Linn failed to find effective distributors and suppliers for their new territories. Distributor selection had been based on a trial and error process. This approach didn’t work, so the firm responded by seeking to set up overseas sales subsidiaries in the US and Germany, and to develop more direct retailer/distributor networks in other countries. Initially, Linn chose to use large international suppliers since it was thought that these would present fewer difficulties, but they proved to be uncommitted to the firm so the firm needed to change the kinds of suppliers it was using. The need for market entry dynamic capabilities was to be able more effectively to learn from their market experiences and better to develop and effectuate a market entry strategy.

Major disagreements with retailers and distributors in the US and Germany in stage III made severe problems in retail/distribution networks highly apparent. Linn response of establishing a distributor support program from HQ did not improve the situation. The outcome of all this was that high sales growth, fueled by internationalization, led the company into loss. Major failings in Linn’s use of global suppliers, and outsourced manufacturers, contract researchers and design offices became very apparent in stage III and continued into stage IV. For Linn, network difficulties by then mainly concerned supply networks, where the learning they needed to address the problems with local flexible suppliers and a reversion to in-house R&D took a long time.
Similarly, the development of overseas subsidiaries appeared initially to be effective, but failings soon emerged. The managers chosen to manage these subsidiaries especially in the US and Germany did not develop effective local businesses: not only were the local management teams ineffective, but HQ had neither the systems to spot their inability, nor the structures and capabilities to deal with it. As well as new distribution and retail networks, new local management/market information systems and procedures had to be developed in stage IV.

The dynamic capabilities needed for sustainable internationalization

We found the case firms needed the three dynamic capabilities for internationalization for market entry, for networking, and for strategic change that we developed from Teece’s (2007) theoretical framework with prior internationalization research, broadly as we expected.

Having recognized that its entry to the US and Germany was not working, its entries into other new territories has been more successful; the firm learned how to understand new markets and to approach them appropriately. The ability to enter and work in markets, through experiential learning, largely reflected the learning ideas lying at the heart of the Uppsala framework model (Johanson and Vahlne, 1977). It is evident that previous internationalization process research has identified the dynamic capability for market entry, even if it has not named it as such. Having learned how to enter new markets effectively, subsequent market entries were more successful.

We also see that as well as for gaining knowledge about market entry, dynamic capabilities are needed for developing operations within a market, and here, it was abilities to work with network partners that were required, as reflected in Johanson and Vahlne’s revised (2003) framework. Gaining successful market entries was followed by severe disagreements with network partners, and Linn being driven into losses. The new subsidiaries did not have the necessary capabilities to monitor and manage the relationships: learning was required about how to work with distributors, and to put new systems in place to support distributors from head office with information, knowledge, and direct support. Internationalization process research has tended to emphasize firm’s exploring capability to do networking with suppliers and distributors’ this was evidently needed by Linn, but firms also need the exploiting capability to work with them effectively as well.

Failings at each stage of internationalization led to the need for new strategies at subsidiary and at corporate level. New subsidiary strategies were needed at it became apparent that
while the trend in Europe is towards direct business and away from distribution, the trend in Asia is towards distribution. Linn used distributors in US and Germany in Stage II, then shifted to foreign direct investment before withdrawing from the market as it found that it didn’t have the expertise to manage subsidiary or expertise as a distributor, so now uses independent retailers. The strategy for Asia, its growth market is based on combining market awareness with rigorous assessment of its own capabilities. The Asian subsidiary is using independent retailers and multi distributors, supported by a strong web presence, where it has some experience and expertise, but not online sales where the firm does not. The underlying dynamic capability here was to develop strategies in the different main territories and not leave that work to HQ, as Cavusgil and Zou (1994) describe. By stage IV, for example, the local managements in Asia found that their market reputation had developed sufficiently that they could put distribution out to tender: a capability to exploit developed from one to explore.

By stage IV, however, it is not only necessary to be able to strategize locally, but the dynamic capability of being able to develop an overall multinational strategy that can embrace local market strategic choices and decisions becomes necessary. For example, having brought product development back in-house, by stage IV Linn needed to develop global systems for capturing market information and feeding it into product development. The exploitative capability is needed to captured and share not only market and marketing knowledge, but also knowledge about goals and strategies, organizational culture routines and know-how for helping the management of the firm as it emerges into becoming a multinational business (Jonsson and Foss, 2011).

*How the dynamic capability needs changed through the internationalization process*

With the perception of the need for the development of new dynamic capabilities, in each case, being driven by business failing with the previous capability set, the process of acquiring and developing the new capabilities involved profound change: in effect, the capability sets were completely changed. This involved managers consolidating the business, by scrapping some capabilities in a process of retrenchment and building, amassing, and bundling a new set of capabilities around a new business model. This process happened in each stage, when the failings faced pointed to new sets of dynamic capabilities: the firms’ needs for dynamic capabilities were quite different in stage II than in stage III, and as a result, the development of the new dynamic capabilities took place at different stages of internationalization, as illustrated in Figure 3.
Figure 3: A dynamic process of dynamic capabilities needs and development

At point A firms are internationalizing for the first time: the focus of attention of internationalization process research, and their main capability need, not surprisingly, is for gaining entry into the new markets. The internationalization that takes place may well be successful in terms of gaining international sales, as Linn found, but there is no reason why this success will represent sustainable internationalization, because the business may not be profitable. In Linn’s case, profits fell as overall international sales increased, and by point B Linn had to withdraw from markets.

A new local business model may well be needed, requiring new relationships with supplier and distributor networks, which itself requires the ability to find those network relationships and seize them in such a way that they can be exploited appropriately. For Linn, sales globally shrank as the firm retract into profitable segments globally, but the development of new network relationships, of different types in different territories, led to profitability and a more sustainable outlook.

By point C, failings were detected in the local and global strategic management of the firm, requiring the capability to reconfigure with new strategies in local subsidiaries and, separately, in the embryonic MNE as a whole. On this basis Linn is now achieving sales increase in new territories, especially in Asia, and in so doing the firm is its benefiting from the capabilities that it developed as a result of its failings in the USA and Germany. We
therefore see the capability needs and the capability developments taking place in different stages; ultimately, a sustainable position as an embryonic multinational enterprise requires all these capabilities.

Conclusions

Internationalization process research has paid little attention to the issue of sustainability in internationalization (Zahra, 2005). The Linn story shows how market entry itself is pointless and can be destructive. We need to examine sustainable internationalization, in doing so this study has shown that value of the dynamic capabilities concept. The resource characteristics, resource combinations and dynamic capabilities that drive the entrepreneurial behavior necessary at the heart of the internationalization process render the dynamic capability perspective particularly pertinent (Foss, Klein, Kor, & Mahoney, 2008). We would argue that attention to the dynamic capabilities required at different stages of a firm’s internationalization will help internationalization process research not only to escape its myopic focus on market entry; it will help it to find a renewed relevance in the world of internationalization practice.

The case shows how a failure to consider the necessary capabilities before internationalization activities are pursued is likely to lead to severe adverse consequences. Linn was fortunate; it has become a highly successful international business. But its operations in the USA and Germany were not just delayed or unsuccessful, but permanently crippled by its failure to acquire the necessary dynamic capabilities. In Linn’s case, these were to set up processes to acquire sales and marketing information and put in place subsidiary management processes before market entry. It followed an incremental, experiential learning process of trial and error, of a type implicit in the Uppsala model (Johanson & Vahlne, 1977; 1990). This approach to internationalization is not appropriate to develop a sustainable international business, as Linn, with the benefit of hindsight, and having survived, might ruefully agree.

The findings of this study therefore suggest that dynamic capabilities are useful in identifying capabilities needed for sustainable internationalization. Although previous internationalization and international entrepreneurship research has indicated what these are, this research is part of a new research avenue that helps to make the dynamic capabilities needed for internationalization more explicit. This study has focused on and enriched understanding of three, based on Teece’s (2007) framework and four decades of internationalization process research. In early stages of internationalization the dynamic
capability to sense and seize knowledge for market entry was needed the most, which Linn acquired in an experiential way, though other ways may well have been adopted to avoid the worse of the mistakes that were made, as Fletcher and Harris (2012) suggest.

The study also identified that this knowledge is not only about market entry, but also concerns how firms may achieve further development into markets once established in them. For sustainability, however, market entry is not enough; firms need to have the dynamic capabilities to sense and seize network relationships if they are to develop a business model that makes business sense. And having established a stable business here, the firm may need to be able to reconfigure and reorient its business in the face of internal and external changes, locally and internationally, if it is to develop in a sustainable way (Eisenhardt and Martin, 2000; Teece et al., 1997; Teece, 2007).

Internationalization offers potential high growth for smaller firms (Autio, Sapienza, & Almeida, 2000), but it is a high risk activity (Sapienza et al., 2006), and mistakes can be costly. The failings that the case firm, Linn faced caused immense costs and difficulties, that could have been averted, at least partially, only by gaining the necessary capabilities before their needs became so painfully apparent, but the need for them was not then realized. There would appear to be great potential for international business research to be able to define and interpret these dynamic capabilities still more precisely, and to identify ways that they can be established within internationalizing firms as, or just before they are needed. If they can, international business research will have found an area of very high managerial relevance. In so doing, it will also have taken the concept of dynamic capabilities from being an elegant concept with little empirical, let alone managerial operationalization, to one that will be of value both to international business researchers and to the managers of internationalizing firms.
References


### Appendix A

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<th>Company interviews</th>
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