Hogeschool van Amsterdam
Amsterdam University of Applied Sciences

INTERNATIONALIZATION AND THE DUTCH FASHION INDUSTRY

AN INVESTIGATION OF INWARD AND OUTWARD INTERNATIONALIZATION

EDITED BY LORI DIVITO AND WILLEM VAN WINDEN

CREATING TOMORROW

Internationalization and the Dutch Fashion Industry

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COLOPHON

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The studies in this book were written by students from the International Business School at the University of Applied Sciences Amsterdam and in cooperation with the Knowledge Economy of Amsterdam research center.

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1

INTRODUCTION: INTERNATIONAL BUSINESS AND ITS MANY FACETS

Lori DiVito

This book is a compilation of three student thesis projects, written by fourth year students from the International Business and Management Studies program at the Amsterdam University of Applied Sciences, International Business School. Their final theses are included in their original form. The only adaptations are the inclusion of this introductory chapter and the concluding chapter.

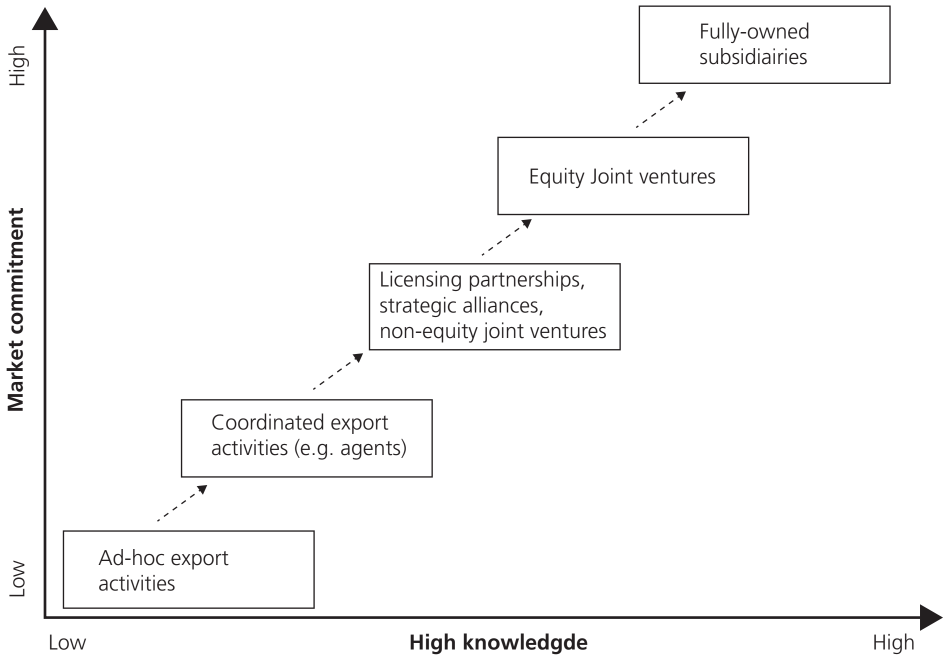
The overall topic of this book is internationalization. It is hard to deny that organizations are increasingly internationalizing in order to remain competitive, to access growth markets and resources and to reduce operating costs. Understanding international business has become imperative for academic researchers, business managers and policy makers but also for students as they prepare themselves to enter an increasingly complex business environment. The subject of *International Business* can be viewed from many angles and general interest in the subject, as educators, researchers and business professionals, has grown exponentially. A simple Google Scholar search on the keywords “international business” delivers nearly 1 million articles and, as a teacher, I can choose from 258 “international business” textbooks. It is, therefore, necessary in this introductory chapter to provide some background on the subject and to adequately describe the scope and context of the international business that we focused on in the series of studies that follows.

1.1 THE INTERNATIONALIZATION PROCESS AND ITS IMPLICATIONS FOR FIRMS

Largely because of the media attention focused on the advantages and disadvantages of globalization, it is common to think that doing business internationally, across borders, is a recent phenomenon. Nothing could be farther from truth. Businesses, merchants, traders have been conducting international business for centuries. It's just that recent developments in information technology and transportation have made the extent to which we are globalized unparalleled in comparison to the past. We communicate and move around much more quickly than we did hundreds of years ago, and many businesses can simply not survive without having an international reach.

Some of the early research done on international business focused on understanding how firms become international, the process or steps involved in learning to operate internationally. One of the widely accepted views is the Uppsala model (Johanson and Vahlne, 1977), so called because of the university where the studies were conducted. Simply put, the Uppsala model basically tells us that the ways in which firms internationalize is related to their market knowledge and market commitment of the country where they want to conduct business. So, if firms are new to internationalization, they start by exporting their products. As they gain knowledge and become more experienced in operating internationally, they move along the commitment pendulum and invest either by entering into more committed strategic alliances or by making foreign direct investments (FDI) (e.g. acquisitions, subsidiaries or greenfield investments). Figure 1.1 illustrates how the increasing levels of knowledge and commitment are associated with an increasing level of risk in international operations. The steps also represent the various ways that firms can enter new markets, or market entry modes. Four widely used access strategies (mode to entry) include: export, licensing, joint ventures (weak FDI) and fully owned subsidiaries (strong FDI).

FIGURE 1.1 MODES OF FOREIGN MARKET ENTRY RELATED TO MARKET COMMITMENT AND KNOWLEDGE

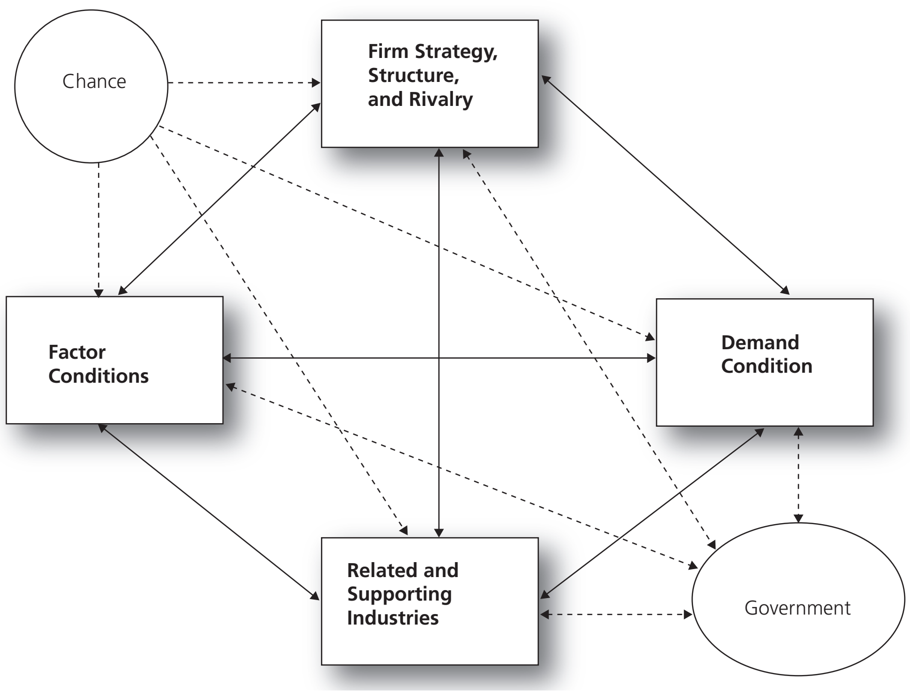


But understanding the steps taken to become international (or to become a multinational enterprise (MNE)) is not enough. In addition to *how*, another strategic concern is *where* to internationalize. The eclectic paradigm, or OLI model, (Dunning, 2000) offers some guidance here. The OLI model stands for: ownership advantages, locational advantages and internalization advantages. This model basically provides a framework for making FDI decisions. It asserts that:

– there are *ownership advantages* if a firm has competitive advantage (relative to the country of investment) from brand equity, specific production techniques or skills, economies of scale, or other internally owned assets, therefore increasing its business growth or volume;
– there are *locational* advantages if the foreign country has immobile, natural (or created) resource endowments (e.g. raw materials, low-wage labor, specialized knowledge or skills) that complement a firm's own competitive advantage;
– there are internalization advantages of coordination and control (e.g. intellectual property protection, distribution control, cost control) when a firm chooses to internalize foreign operations (strong FDI) rather than use 'market' transactions[1] (export, licensing, franchise, supplier agreements).

Another model that is important to understanding the decision of where to internationalize is Michael Porter's Diamond model (Porter, 1990). While the Uppsala model and the OLI model have a view of internationalization that is centered on the firm, Porter's Diamond model takes a broader industry view. It is used to help explain locational benefits and why industrial specialization in cities or regions or nations occurs. In other words, the features of locations that make it attractive for firms to establish or retain operations in certain places. In this sense, it is the location (local, regional or national levels) that offers competitive advantages. There are four determinants of the diamond model: i) firms, their strategy, structure and rivalry ii) related and supporting industries or institutions, iii) demand conditions, a strong home market, and iv) factor conditions, the natural or created resource endowments. Government policy and chance events influence these four different aspects and affect either positively or negatively the competitive advantages of a particular location. Figure 1.2 is an illustration of the diamond model.

FIGURE 1.2 PORTER'S DIAMOND MODEL, ADAPTED FROM *THE COMPETITIVE ADVANTAGE OF NATIONS*



Source: Porter, 1990, pg 127

1 This decision is also referred to as "market vs. hierarchy" or "make vs. buy". "Buying" on the market through transactions is external to the firm whereas "making" is internal and requires (hierarchical) firm structures for coordination and control.

Locational competitive advantages are intrinsically linked to internationalization; recall the L in the OLI model. Influenced by their contextual environment, they evolve and change as, for example, buyers' preferences might change affecting demand conditions, or technological innovation might replace certain skill sets affecting supporting industries, or severe weather (or war, for that matter) might occur affecting access to natural resources. It is easier to understand this by taking two concrete examples: Silicon Valley in California and Detroit, Michigan. Silicon Valley gained ground in the 1970s for having exceptional locational benefits for high-tech entrepreneurs. A high-tech firm or start up from anywhere (e.g. Boston or London) may find it beneficial to have a subsidiary in Silicon Valley in order to access local knowledge and other resources, like specialized venture capital. Governments around the world have tried to replicate the set of systems (or conditions) that create Silicon Valley's locational advantages with varying degrees of success (Casper, 2007). If we look at Detroit, it was an example of exceptional locational benefits for the automotive industry in roughly the first half of the 20th century (Klepper, 2002a). Today, there is not much left of the automotive industry in Detroit, which is the largest US city to declare bankruptcy.[2] American car companies have long realized the production and cost benefits of moving manufacturing activities overseas to low-wage countries. An interesting question to ask is why Detroit lost its locational advantages whereas Silicon Valley has been able to retain or perhaps renew these advantages (Saxenian, 1994).

In an article in the Harvard Business Review by Pisano and Shih (2009), the authors heed warning that America is losing its 'industrial commons', another way of referring to locational benefits. They claim that after decades of outsourcing America has lost its semi-conductor manufacturing base and with that its competitiveness in that sector. Pisano and Shih are pointing out that outsourcing parts of the value chain that may be less competitive on a global scale (like semi-conductor manufacturing, car manufacturing or even textile manufacturing) makes economic sense, but in the long run destroys crucial industrial commons as it also decreases the demand of certain skills, capital equipment, educational programs, suppliers or service providers (for example) and the commons slowly disappear. Perhaps this is an explanation of why Detroit's locational advantages dissipated.

Within the context that has just been outlined, strategic management scholars have been picking apart the pieces of the internationalization puzzle for decades. There are questions on the firm level in regards to internationalization and firm size, motivations, return on investment, divestment, organizational structure, control, knowledge and learning, value creation and value capture. There are questions on an industry level about complementary resources, development and accessibility of specialized skills and labor, competitive behavior, strategic alliance management. And then there are questions on policy levels, governments and the policies they create and implement that either support or hinder sustainable industrial development. Locational benefits evolve and change accordingly.

1.2 INTERNATIONALIZATION AND SUSTAINABLE COMPETITIVE FIRM CAPABILITIES

Scholars have long espoused that firms should focus more on their core competences or capabilities and outsource secondary activities, doing what they are good at and ultimately becoming more competitive

2 July 19th, 2013, BBC News, http://www.bbc.co.uk/news/world-us-canada-23369573

(Prahalad and Hamel, 1990). Therefore, firms continuously explore and exploit locational advantages where and when possible. If firms are outsourcing and externalizing value chain activities, this leads to a greater fragmentation of their activities and increases the associated costs of the coordination and control of external partners. Also, there is often between manufacturing and design, development or engineering, a learning loop (Malmberg and Maskell, 2002) that is broken by outsourcing. When these activities are internalized, much can be learned from the manufacturing process that might translate into incremental product innovation (Klepper, 2002b). In outsourcing, firms lose these learning opportunities and potentially jeopardize their innovative capacity. It's this loss on an accumulated industry level that Pisano and Shih refer to. Arguably, firms can foster and commit to learning relationships with their external value chain partners, but as we'll see from the studies in this book, this is a complex and difficult process, especially for small firms.

If knowledge and learning are the building blocks of firm capabilities, a firm's uniqueness is often attributed to its ability to create and integrate new knowledge into the organization (Argote and Ingham, 2000; Grant, 1996; Kale, Dyer, Singh, 2002; Kogut and Zander, 1996; Teece, Pisano and Shuen, 1997). While firms in a specific industry may share similar characteristics due to a similar pool of resources, it is the idiosyncratic patterns of knowledge creation and integration from complex social relationships that set them apart from each other (Nonaka, Toyama and Nagata, 2000). In this way, individuals and their relationships with others inside and outside the organization are an integral component of a firm's competitive advantage (Dyer, Singh, 1998; Lavie, 2007). The potential for a firm to convert knowledge into organizational learning that is used for improving routines, creating new products or changing capabilities will depend greatly on *who* inside and outside the organization is participating in the process of knowledge creation and *how* that process is taking place (Nonaka et al, 2000).

As discussed in the prior section, internationalization is either direct (strong and weak FDI) or it is indirect through exporting or licensing. In both cases, it involves partnerships and learning from international partnerships is a complex and misunderstood process (Inkpen, 1998; Nonaka et al, 2000). Learning requires firms to have a certain level of absorptive capacity (Cohen and Levinthal, 1990), of which there are four dimensions (Zahra and George, 2002): i) *acquisition*, the ability to acquire externally generated knowledge; ii) *assimilation*, the ability to analyze, process and interpret the acquired knowledge; iii) *transformation*, the ability to improve or develop new organizational routines that enable firms to combine their stock of knowledge with the acquired and assimilated external knowledge; and lastly, iv) *exploitation*, the ability to leverage existing competences with newly created ones, generating benefits (e.g. profit) from incorporating the acquired, assimilated and transformed knowledge from external sources into their operations.

How might firms learn from internationalization? Scholars have shown that the type of partnership (e.g. strategic alliance, joint venture, etc.) influences learning and value creation (Anand and Khanna, 2000). Joint ventures have a positive correlation between learning and value creation, whereas learning from licensing partnerships has a neutral effect on value creation. Studies also show that learning is more apparent in joint ventures that focus on R&D or production and is limited in marketing joint ventures (Lam, 2003). Furthermore, scholars (Lane et al, 2001) have seen that knowledge relatedness between partners (the similarity of their knowledge bases) facilitates knowledge transfer and trust, which influences the ability to understand, assimilate and apply knowledge. Makhija and Ganesh (1997) argue that to accomplish knowledge transfer and learning partners need to participate actively in the relevant processes in which knowledge is embedded. Visits and tours of the partners' sites are effective ways of accessing tacit knowledge[3] from partners (Inkpen, 1996) but in order to exploit the knowledge, first-hand experience with the partner is essential and usually achieved by appointing expatriate management at the partner's site (Inkpen and Crossan, 1995).

However, Tsang (2002) discounts this view and asserts that firms learn from their overseas partners even if they don't acquire skills (Luo, 1999). Tsang claims that firms absorb knowledge from their international joint venture partners through two mechanisms: i) *overseeing effort* which involves the supervision of the JV partner by the parent through primarily communication, and ii) *management involvement* which differs from the former by focusing more on daily operations and having physical presence in the JV by assigning expatriate management. Overseeing effort is important and crucial when the geographical distance is great. Management involvement is crucial for learning. Tsang (2002) found that overseeing effort is more important for firms with experience in international joint ventures while management involvement is more important for firms without experience. An important insight from Tsang's study is that learning has an asymmetrical pattern and that once a parent has improved its information processing capacity (overseeing effort), either by experience or longevity of the partnership, less managerial involvement is needed.
It suggests that 'overseeing effort' is a necessary condition for continuous learning in international partnerships.

To summarize the main points from these prior sections briefly, firms internationalize to gain locational benefits and there are several different modes of entry that a firm can decide to use. Each entry mode has implications for coordination and control and has exposure to different levels of risk. However, to create sustainable competitive advantage firms need to continuously learn and adapt their core competences or capabilities. Knowledge is essential to this learning process. Firms therefore need to be able to acquire, assimilate, integrate and transform knowledge from their external partnerships to their internal processes and routines.

1.3 THE RESEARCH SETTING

The prior sections outline the context in which the three studies in this book should be seen. Collectively, the studies address several aspects of internationalization of the Dutch fashion industry. We chose the fashion industry because it is an industry dominated by SMEs and internationalization; the outsourcing of manufacturing is commonplace. Since the 1970s, manufacturing in the fashion industry has undergone significant changes, leading to the fragmentation of the value chain (Gereffi, 1999) and the decline of fashion/textile manufacturing in developed countries (Lane and Probert, 2009). As in other developed countries, the manufacturing of clothing and textiles in the Netherlands has been largely, if not completely, off-shored, making it essential for Dutch fashion firms to engage with international partners (Wenting, Atzema and Frenken, 2011). Additionally, the Netherlands is a small country economy with a

3 Generally there is a distinction between explicit and tacit knowledge. Explicit knowledge is codified in specifications, procedures and manuals and can be easily copied or transferred between individuals and firms. Tacit knowledge is contextual and socially-embedded in individuals, locations and networks and is difficult to transfer, imitate, share and acquire.

limited home market. In small country economies, SMEs tend to internationalize more quickly in order to benefit from scope and scale economies; so, Dutch fashion firms engage in internationalization from a relatively young age (Boter and Holmquist, 1996; Gassman and Keupp, 2007; Karra, Phillips and Tracey, 2008).

1.4 OVERVIEW OF THE BOOK

This book is a compilation of three student theses and as such chapters 2, 3 and 4 represent each respective thesis. Chapter 2 is the thesis written by Toyah Siegel. She investigated the locational conditions of two cities that attract young fashion designers: Amsterdam and Berlin. It is a comparative case study of eight fashion designers, all of which are young firms. She explored how these designers accessed critical resources such as financing and customers and how they used their network ties in accessing these resources. She also identified the different resource endowments of each location and made comparisons between Amsterdam and Berlin.

Chapter 3 is the thesis written by Gabriela Suruceanu. She investigated international production partnerships of small and medium sized fashion firms, specifically exploring the relation between the type of international partnership and quality control mechanisms. As discussed in a previous section, different types of partnerships (e.g. strategic alliances, joint ventures) are associated with varying levels of control. The expectation is that small and medium sized fashion firms would have limited control over the partner due to limited commitment and equity investment. Suruceanu used a mixed method approach of qualitative and quantitative data collection and analysis, drawing on four in-depth interviews and a joint survey conducted with Charelle Felix.

Chapter 4 is the thesis written by Charelle Felix who also investigated international production partnerships but then with a focus on managing corporate social responsibility and specifically labor-related issues. Felix looked more closely at the relation between production variables, such as volume and quality issues, and labor non-compliance. She also looked at the relation between labor non-compliance and the adherence to labor guidelines. Felix conducted an initial exploratory interview with a fashion firm that had experienced labor non-compliance and used insight from the interview to inform and guide further data collection. Using survey data that was gathered jointly with Suruceanu, she used quantitative methods to analyze the data.

Lastly the concluding chapter, chapter 5, synthesizes the findings of the studies by first summarizing them. The findings are discussed further in the broader context of the literature, reflecting on how they add to the broader body of knowledge on internationalization and international supplier relations. The implications for industry practitioners, such as fashion designers, entrepreneurs, firms or other industry participants, are presented, as well as the implications for policy makers. The concluding section closes with some suggestions for further avenues of research.

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