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## Exploring the role of internationalization knowledge in fostering strategic renewal: A dynamic capabilities perspective

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## ABSTRACT

Internationalization knowledge (IK) is important to successfully enter and develop competitive strategies abroad. Yet, how IK is advanced and improved across the multinational enterprise (MNE), and how this contributes to the MNE's strategic renewal is less understood. This analysis is based on an in-depth case study of Microsoft International to explore how IK is advanced, improved, and integrated across the enterprise. Our findings suggest that IK plays a critical role in fostering strategic renewal of an MNE. More specifically, sensing, seizing, and transforming capabilities jointly provide the necessary basis that enable IK to facilitate strategic renewal. We contribute to the literature by (1) explicating three categories of IK and their hierarchical relationship; (2) reveal how three distinct capabilities required by MNEs capture and integrate the three categories of IK across the enterprise; and, (3) offering that strategic renewal is triggered by routines based on the development and integration of IK.

### 1. Introduction

Concerned primarily with the multinational enterprise's (MNE's) international market performance, international business (IB) literature provides the scholar and practitioner with studies related to internationalization and the MNE's knowledge to successfully accomplish this process (Fletcher, Harris, & Glenn, 2013; Johanson and Vahlne, 1977, 1990). Referred to as internationalization knowledge (IK), the knowledge gained in internationalization is viewed as an enabler for an MNE; a crucial means to successfully leverage its existing capabilities across new geographic markets and, thus, to create and capture value. Thus, IK serves as a fundamental basis for understanding internationalization theory (Johanson and Vahlne, 2009; Johanson & Vahlne, 2009).

Eriksson, Johanson, Majkgard, and Sharma (1997) define IK as “experiential knowledge of a firm's capability and resources to engage in international operations” (p. 343). This knowledge is the “firm-specific way of going international” (Eriksson et al., 1997, p. 345) that results from experience accumulated across all foreign-operated markets (Blomstermo, Eriksson, Linstrand, & Sharma, 2004; Fletcher et al., 2013). IK is critical to MNEs for at least two reasons. First, it shapes the internationalization strategy of the firm as knowledge is gained and integrated “as a consequence of learning both a firm's capabilities and

foreign market's needs” (Eriksson et al., 1997; Eriksson et al., 1997, p. 353). Second, it can alter the content and process of an MNE's internationalization strategy to enhance its long-term prospects (*i.e.*, strategic renewal) (Agarwal and Helfat, 2009; Agarwal & Helfat, 2009).

Despite recognizing the importance of IK to the internationalization and subsequent success of MNEs, few studies investigate how IK is developed and integrated across the enterprise, and how IK is used in the process of strategic renewal. Previous research focuses on knowledge differences across countries in terms of culture, institutions, development, or decision-making processes that create a parent liability of foreignness and outsidership in local markets (Johanson & Vahlne, 2009; Kogut & Zander, 2003). Thus, IK represents a multifaceted amalgamation of knowledge types in the international space and plays a critical role in the process of successfully entering and operating new foreign markets (Eriksson et al., 1997; Fletcher et al., 2013). However, understanding how IK is developed and integrated across the enterprise remains under-researched.

Moreover, the IB literature suggests that internationalization contributes to both value creation and capability expansion abroad. In this vein, internationalization is consistent with a firm's “need to encompass multinationality” for sustained competitive advantage over time (Teece, 2014, p. 23; see also Doz et al., 2001; Lessard et al., 2013). Yet, this literature rarely considers the role of IK explicitly in the process of

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shaping internationalization strategy in terms of both content and process. There is evidence that firms learn to explore and capture opportunities (Bingham and Eisenhardt, 2011) and that, for instance, the location choice decision enhances responsiveness to global opportunities with the experience the firm gains (Davidson, 1980). However, a gap in understanding remains regarding how IK is developed and integrated across an enterprise to alter internationalization strategy in terms of content and process, or in other words, strategic renewal.

Our investigation aims to fill this gap and extend the literature on IK by investigating three related and important questions: (1) how IK is advanced and improved through internationalization efforts; and (2) how new knowledge is captured and integrated into the existing IK resource base; and (3) the role of IK in fostering strategic renewal in an MNE. To address our related questions, we adopt a dynamic capabilities perspective in order to understand how IK is developed and integrated across the MNE. Dynamic capabilities describe the processes and routines that enable a firm to renew, adapt, or reconfigure its resource base in response to dynamism in the external environment (Davis, Eisenhardt, & Bingham, 2009; Pablo, Reay, Dewald, & Casebeer, 2007; Teece, Pisano, & Shuen, 1997; Valhne & Johanson, 2013; Zhou & Li, 2010). From this perspective, IK is a unique resource (Fletcher et al., 2013; Valhne and Johanson, 2013) that, through dynamic capabilities, can be developed and integrated to strengthen or maintain the MNE's competitiveness across markets (Teece et al., 1997). Thus, a dynamic capabilities perspective might be useful when investigating IK because it provides insight into the MNE's ability "to be prescient and sense opportunities and threats" (Teece, 2014, p. 18) and strategically renew by "creating, extending or modifying its resource base" (Helfat et al., 2007, p. 7).

To explore our related research questions, we adopt an instrumental in-depth case study approach. A case study approach is appropriate because it enables us to explore IK and strategic renewal within a particular context bounded by time and space, thus offering in-depth, contextualized insight (Creswell, 2012; Stake 1995). By studying the phenomenon in a single case study, knowledge discovery may occur by focusing on the lenses of experienced individuals in a bounded context. In this study, we use interviews with senior managers involved with internationalization decision-making and international strategy formulation at Microsoft International (MSI), the international market headquarters of Microsoft Corporation. MSI is an appropriate and desirable setting for this research for multiple reasons. First, MSI operates in the technology sector, which is highly dynamic, and at times, volatile (Cannone and Ughetto, 2014; Davis et al., 2009). Thus, MSI must continually search for ways to create, extend, or modify its IK resource base to strategically renew and by extension and as noted in prior literature, underpin its competitiveness through competitive advantage. Second, MSI has a history of internationalization. This history provides an avenue "for understanding the origins of capabilities" (Teece, 2012, p. 1398) in light of strategic renewal required to remain dynamic in this ever-changing market sector. Third, MSI is an industry leader and one of the most internationalized corporations in the world. Thus, it allows for understanding the role of IK in differentiating MSI "from competitors [to] provide competitive advantage" (Wilcox King and Zeithaml, 2003, p. 764).

Our study offers several contributions to IB research. First, we contribute to the IK literature by explicating three categories of IK: localization knowledge, market entry knowledge, and international enterprise knowledge (Fletcher et al., 2013). We extend this literature by revealing how these categories of IK are improved and advanced in MNEs, and also elucidate a hierarchical relationship among the three categories of knowledge. We find that building localization knowledge and market entry knowledge serves to advance and improve international enterprise knowledge. Second, our findings support existing research that highlights the role of capabilities to knowledge integration (Grant, 1996). We contribute to the literature by suggesting that three distinct capabilities are required by MNEs to integrate the three

categories of IK developed in the process of internationalization. Third, we demonstrate the role of the IK-specific capabilities in fostering strategic renewal in an MNE. Our findings suggest that both incremental and discontinuous renewal can be triggered by the creation of routines based on the development and integration of international enterprise knowledge. IK-specific capabilities are therefore "high-level routines (or collection of routines)" that confer a "set of decision options for producing significant output of a particular type" (Winter, 2003, p. 991); in this case, decisions related to strategic renewal.

## 2. Internationalization knowledge, dynamic capabilities, and strategic renewal

Internationalization knowledge can be defined as "general knowledge about how to engage in international operations" (Fletcher et al., 2013, 49). IK has three central components (Fletcher et al., 2013). First, it is firm-specific. IK is developed within an MNE given its past experiences with internationalization based on its existing routines, processes, and resource base (Teece, 2012). Second, IK is a specific form of organizational knowledge. Whereas organizational knowledge is defined as "all the tacit and explicit knowledge that individuals possess about products, systems and processes...routines, culture and know-how" (Bryant, 2003, p. 33), IK represents the firm-specific tacit and explicit knowledge particular to the MNE's internationalization efforts as evidenced in products, systems, processes, routines, culture, and know-how. Third, IK emerges from knowledge acquired and transferred between headquarters and international locations. Thus, an MNE's ability to integrate IK represents a fundamental organizational capability (Grant, 1996).

IK may be a critical input to strategic renewal in MNEs (Verbeke et al., 2007). Broadly, strategic renewal is defined as "the process, content, and outcome of refreshment or replacement of attributes of an organization that have the potential to substantially affect its long-term prospects" (Agarwal and Helfat, 2009; Agarwal & Helfat, 2009, p. 282). Strategic renewal can be both discontinuous (representing a rather large or abrupt change to strategy content or implementation) and incremental (representing a continuous effort to shift or alter strategy content or implementation). In either case, injections of IK in both tacit and explicit knowledge can help the MNE uncover new knowledge (Crossan and Berdrow, 2003; Crossan & Berdrow, 2003) and make improvements or adjustments to the existing internationalization strategy in an effort to increase long-term prospects and future success.

### 2.1. Three categories of IK

Recent advancements in the IK literature suggest three categories of IK: (1) localization knowledge, (2) market entry knowledge, and (3) international enterprise knowledge. Localization knowledge describes the knowledge MNEs need to compete in foreign markets (Fletcher et al., 2013) and is important to the development of local strategies that yield a competitive position (Eriksson et al., 1997; Prashantham & Young, 2011). Localization knowledge enables MNEs to "source competitive knowledge, evaluate necessary and available capabilities to develop competitive strategies, and implement appropriate competitive and/or collaborative strategies in new territories" (Fletcher et al., 2013, p. 51). Localization knowledge is critical for MNEs to understand local market conditions (Cui et al., 2005; Cui, Griffith, & Cavusgil, 2005), match the MNE's capabilities to these conditions, build a local business network, and apply this knowledge to other similar market locations (Roth et al., 2009; Roth, Jayachandran, Dakhli, & Colton, 2009).

Previous research describes a pattern of knowledge flows in MNEs: (1) subsidiary to parent; (2) location to subsidiary; and (3) subsidiary to location, and indicates that flows from subsidiary to parent require "particularly strong and unique local competencies or by particularly strong company-specific networking capabilities" (Mudambi and

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