The international diversification-performance link in Spain: Does firm size really matter?

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A R T I C L E   I N F O

A B S T R A C T

This study provides new insights into the link between international diversification and firm performance in a sample of large manufacturing firms and SMEs based in Spain for the 1994–2008 period. Specifically, the focus is on how the nature and shape of this relationship may vary over time with firm size. The results show the existence of a horizontal-S curve when the whole sample of firms is considered in the empirical analysis. However, major differences are found between SMEs and large firms, and even within the actual group of SMEs. Strong support is found in large firms for the existence of a horizontal-S curve. Within the group of SMEs, there are small firms with a linear and negative relationship, whereas medium-sized firms record a U-shaped form. These findings suggest that as the international diversification-performance link is size-dependent, future research should explicitly consider firm size in order to better understand the nature of this relationship.

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1. Introduction

Recent years have seen firms increasingly expanding into international markets. This deployment has meant that research into international diversification (ID, hereafter) has aroused considerable interest among scholars (Chang & Wang, 2007; Hitt, Hoskisson, & Kim, 1997; Pla-Barber & Alegre, 2007). Accordingly, the research question of whether ID has a bearing on firm performance (P, hereafter), and how it does so, has become an especially relevant, albeit controversial, study topic within the field of international business studies (Bausch & Krist, 2007; Hennart, 2011; Hitt, Tihanyi, Miller, & Connelly, 2006; Kirca et al., 2011).

There is a well-known lack of consensus among researchers on the nature of the link between ID and P. Some researchers find a linear and positive link (e.g., Delios & Beamish, 1999; Pangarkar, 2008; Rugman, 1979), while others find a negative effect (e.g., Brewer, 1981; Collins, 1990; Colpan, 2008). Yet the assertion of

linearity between the degree of ID and P has been challenged by an increasing number of empirical studies in recent years. Thus, significant results seem to range from a U-shaped curve (e.g., Kistruck, Qureshi, & Beamish, 2013; Qian, 1997) to an inverted U-shaped one (e.g., Driffield, Du, & Girma, 2008; Hitt et al., 1997). Finally, other studies find a horizontal S-shaped relationship (e.g., Contractor, Kundu, & Hsu, 2003; Fisch, 2012; Lu & Beamish, 2004; Sung, Bell, & Park, 2008).

This study provides new insights into this important debate, which is still ongoing in the field of international business, especially at a time when business managers across the board are fully aware that competition is being played out in an increasingly globalized competitive arena. Specifically, it seeks to answer the two following interrelated questions: (1) what effect does ID have on firm performance in a country? (2) Is the nature and shape of this effect similar in small, medium and large firms or, by contrast, does each group of firms record different internationalization patterns? By answering both questions, this study intends to look into the role that context and, mainly, firm size can play in the ID–P relationship.

Most past research on the ID–P relationship has been primarily interested in exploring large MNEs. There are only a handful of

studies focusing on SMEs (e.g., Chiao, Yang, & Yu, 2006; Fisch, 2012; Hsu, Chen, & Cheng, 2013; Lu & Beamish, 2001; Pangarkar, 2008; Qian, 2002). There are virtually no empirical studies that have simultaneously examined such a link in a single sample of large firms and SMEs. In fact, until recently, the field of international business has generally been more concerned with large MNEs than SMEs. The lack of evidence on SMEs is somewhat striking given that these firms make a major contribution to an economy in terms of both employment and gross value added.[1] Moreover, the consideration of a large sample of firms of different sizes is more representative of the internationalization strategy and its link to the performance of a country's industrial fabric. Thus, this study is one of the first attempts to explore the effect that ID may have on P in a panel of firms that includes both large firms and SMEs. A marked exception is, to a certain extent, the study by Fisch (2012), who finds support for the existence of a horizontal S-shaped curve in the full panel and subpanels of SMEs and large firms, although the shape of the ID–P link is attenuated for large firms.

However, unlike Fisch (2012) and past research exploring SMEs, this study also differentiates between small and medium firms within the actual group of SMEs. Thus, it initially sets out to test the validity of the horizontal S-shaped model in a panel of small, medium and large firms in a developed country (Spain). This model distinguishes three stages—early, mid-stage and highly internationalized firms—and has been confirmed only in advanced economies. Specifically, this model suggests that these economies are more likely to contain a significant number of firms in all stages. Emphasis is placed here on the role that context (i.e., home country) can play insofar as it is assumed that firms in an advanced economy are more likely to record higher degrees of ID than their counterparts in an emerging economy. Yet the horizontal S-shaped model does not in itself allow finding out which specific type of firms may be in each stage when firms of different sizes are examined together. Accordingly, subpanels of large, medium and small firms are then separately analyzed in order to better clarify this issue. This analysis helps to prove the extent to which each specific type of firm has a similar or different ID–P link and, ultimately, provides a more complete and realistic picture of the nature of this link in each type of firm in a country. In this sense, the simple fact that different types of firms in a country are in different stages of the horizontal S-shaped model can be interpreted as clear evidence of a different ID–P link in each specific type of firm. The empirical testing of this issue is relevant because although it is obvious that most firms in today's competitive arena are being forced to compete on an international basis, each type of firm may behave differently insofar as it may differ in terms of resources, ownership and organizational structures or managerial systems (Chiao et al., 2006; Lu & Beamish, 2001; Pangarkar, 2008).

The existing research on the ID–P link has also ignored the time dimension, or has considered short time periods—between 3 and 8 years (e.g., Capar & Kotabe, 2003; Contractor et al., 2003; Fisch, 2012; Gaur & Kumar, 2009; Qian, 2002; Ruigrok, Amann, & Wagner, 2007). In a critical review of existing research, Hennart (2007: 446) posits the need to study how firms expand abroad over long periods, since only in this way is it possible to identify the different stages in a firm's internationalization process. This study covers a longer time period than most prior studies (15 years: 1994–2008). Thus, the large sample of firms and the time period considered, as well as the panel data methodology used, allow

examining and depicting in much greater detail how different sized firms evolve from low levels of ID through to higher levels.

2. International diversification and firm performance

2.1. Literature review

Most studies in the field of international business have traditionally assumed that ID is 'good' for P (Contractor, 2007; Contractor et al., 2003). In fact, the first empirical studies conducted in the 1970s were informed by an overly optimistic view of the potential effects of ID on P. Emphasis was placed on the potential advantages or benefits associated with ID. Clearly, in most of these initial studies researchers also recognized that ID involved significant costs. Yet it has been suggested that the incremental costs associated with higher degrees of ID will be outweighed by the incremental benefits linked to it accordingly. These studies assumed that the greater the degree of ID, the higher P will be. This assumption leads to argue a linear (monotonic) and positive link, as illustrated in Fig. 1 (see Model 1).

Most of the empirical studies arguing for a linear and positive ID–P link underscore the following benefits of ID: (a) the opportunity to exploit market imperfections, mainly related to the use of firm-specific assets—especially intangible ones—in new markets abroad (Caves, 1971; Lu & Beamish, 2004; Rugman, 1979); (b) the access to or arbitrage of cheaper inputs—such as capital or labor—or outputs in the different countries in which the firms are operating (Contractor, 2007; Hennart, 1982; Lu & Beamish, 2004; Vernon, 1966); (c) the reinforcement of a firm's market power over its suppliers, distributors and customers (Contractor, 2007; Hymer, 1976; Lu & Beamish, 2004); (d) the ability to enhance a firm's knowledge base and innovation through experiential learning (Contractor et al., 2003; Ghoshal & Bartlett, 1990; Kogut & Zander, 1993; Zahra, Ireland, & Hitt, 2000); (e) the accumulation of international experience (Contractor, 2007; Contractor et al., 2003; Johanson & Vahlne, 1977); (f) the possibility of realizing global economies of scale and scope (Caves, 1996; Hymer, 1976; Lu & Beamish, 2004; Porter, 1986); (g) the diversification of risk from operating in different countries in terms of political instability, fluctuations in exchange rates, or economic cycles (Contractor, Kumar, & Kundu, 2007; Kim, Hwang, & Burgers, 1993); (h) the potential benefits derived from ID on a global scale that avoid market failure, trade barriers, moral hazards and broken contracts (Contractor et al., 2007); or (i) the ability for the global scanning of potential competitors and markets, as well as other potential profit sources (Contractor et al., 2003).

In due course, scholars in the 1980s and 1990s began to adopt a more pessimistic view on the potential effects of ID. In particular, many authors began to consider that international expansion could be subject to risks and failures, whereby they acknowledged certain drawbacks in the ID process (Bausch & Krist, 2007; Brewer, 1981; Ramaswamy, 1992). These scholars suggest that as the number of foreign countries in which a firm operates increases, international expansion can be expected to begin yielding incremental costs that exceed the firm's incremental benefits. This finding has led several authors to suggest a linear (monotonic) and negative relationship between the degree of ID and P, as illustrated in Fig. 1 (see Model 2). Some of the empirical studies conducted over the past forty years also corroborate this argument (e.g., Brewer, 1981; Collins, 1990; Colpan, 2008; Geringer, Tallman, & Olsen, 2000; Ramaswamy, 1992; Rugman, 1976; Siddharthan & Lall, 1982).

All these scholars proposing a linear and negative ID–P relationship emphasize the importance of the following costs related, in one way or another, to ID: (a) the problems of the liability of newness and foreignness (Hymer, 1976; Johanson &

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[1] In 2012, EU-27 had over 20 million SMEs, which employed almost 87 million people, and delivered almost 3.4 trillion euros. They accounted for 99.8% of all European enterprises, 66.5% of all European jobs for that year, and delivered 57.6% of the overall gross value added generated by the private, non-financial economy (European Commission, 2013).