



# Spillovers through backward linkages and the export performance of business services. Evidence from a sample of Italian firms



Giuliano Conti<sup>1</sup>, Alessia Lo Turco<sup>2</sup>, Daniela Maggioni<sup>\*</sup>

Università Politecnica delle Marche, Department of Economics and Social Sciences, Piazzale Martelli 8, 60121 Ancona, Italy

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## ABSTRACT

We provide evidence on the role of spillovers through vertical linkages in service firms' internationalisation process. We combine input–output coefficients with region-level information on downstream manufacturing sector exports to build a measure of spillovers through backward linkages, which we assess as a systematic determinant of Italian BS firms' export status. Once considered firm and sector specificities, export spillovers especially matter for exporting to high-income economies outside Europe. This finding originates from higher sunk costs stemming from greater distance to the destination market and tougher competition within the destination market. Furthermore, the spillovers' geographical scope is mainly local. We thus contribute to international business theory by generalising existing evidence from case studies on the importance of buyer–supplier relationships for service firms' internationalisation across several BS sectors. Our research carries important implications for international business practices as well, as joining networks with internationalised customers may play an important role in enhancing BS firms' exports, regardless of the BS supplied.

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## 1. Introduction

In recent decades, employment and production have moved from manufacturing to services, which today represent the majority of high-income countries' GDP. Rapid developments of Information and Communication Technology (ICT) and growing global integration have stimulated trade in services – traditionally considered non-tradable – and today more and more services firms face the same international competition pressure as manufacturing firms. Literature has shown that export specialisation plays a relevant role in long-run growth and welfare (Hausmann, Hwang, & Rodrik, 2007; Lucas, 1988), and exporting high-skill-intensive services may become fundamental for the future of advanced countries. It is then crucial to shed light on the determinants of the business services (BS) firms' export propensity in order to gather some insights about countries' economic perspectives.

In this study, we therefore focus on the determinants of services firms' exports and, specifically, we test whether vertical linkages between manufacturing exporters and upstream BS providers act as a channel for the transmission of positive export spillovers which facilitate BS firms' export activity.

Motivated by interactivity, intangibility and inseparability between production and consumption which characterise a large part of services (Blomstermo & Sharma, 2003) and by the upsurge of BS Foreign Direct Investments (FDI) in the last decades (UNCTAD, 2008, 2012), the most recent existing literature has mainly focused on BS trade occurring via the WTO-GATS mode 3, that is via the firm's direct commercial presence with own subsidiaries in foreign markets. As the latter represents the predominant entry mode in services (Lejour & Smith, 2008), literature has then investigated BS firms' penetration of foreign markets in terms of commitment and control (Pla-Barber, Sanchez-Peinado, & Madhok, 2010; Villar, Pla-Barber, & León-Darder, 2012) and, within the general analysis of the international expansion of BS multinationals, a stream of research has started investigating their subsidiaries' linkages with local firms (Miozzo & Grimshaw, 2008; Miozzo, Yamin, & Ghauri, 2012).<sup>3</sup> Nevertheless, as Information and Communication Technologies advance and spread, it is rather likely that many services firms sell their product abroad with the involvement of limited resources. Therefore, less resource-intensive internationalisation modes are viable in the

<sup>\*</sup> Corresponding author. Tel.: +39 071 220 7239; fax: +39 071 220 7102.

E-mail addresses: [g.conti@univpm.it](mailto:g.conti@univpm.it) (G. Conti), [a.loturco@univpm.it](mailto:a.loturco@univpm.it) (A. Lo Turco), [d.maggioni@univpm.it](mailto:d.maggioni@univpm.it) (D. Maggioni).

<sup>1</sup> Deceased.

<sup>2</sup> Tel.: +39 071 220 7250.

<sup>3</sup> In particular, Miozzo and Grimshaw (2008) explore IT service multinationals' forward linkages with client firms in middle income economies and find that clients' absorptive capacity is important in securing positive forward linkages. Also being in a business relationship with an IT service multinational helps clients to become more footloose and less dependent on and connected to the local economy. Miozzo et al. (2012) instead explore the extent of backward linkages and show that the latter is limited as service multinationals tend to prefer global suppliers.

form of services “embodied” in objects, in people and domestically located exports (Ball et al., 2008). The latter modes correspond to the WTO-GATS services exports modes 1, 2 and 4 which identify those of services exports that actually enter the balance of payment definition of cross-border trade in services. The systematic analysis of the determinants of this type of exports has been rather neglected. Only recently has the improved availability of larger samples of services firms allowed for more systematic empirical work on the importance of firm-level services exports determinants – for instance, firm size, productivity, and innovation activity – (Love & Mansury, 2009, for the U.S.A.; Gourlay, Seaton, & Suppakitjarak, 2005, for the U.K.; Eickelpasch & Vogel, 2009, for Germany) and for a comparison with findings for manufacturing firms (Jaklič, Čirjaković, & Chidlow, 2012; Javalgi, Lawson, Gross, & White, 1998).<sup>4</sup> However, despite the centrality of the network perspective highlighted by the services firm internationalisation theory, existing evidence lacks any systematic treatment of the relevance of the relationship with customers in the manufacturing sector for services firms’ export activity.

With this paper we thus aim at contributing to fill this gap and we address the following main research question: is upstream BS providers’ export activity systematically favoured by spillovers accruing through vertical linkages with downstream manufacturing exporting firms?

Our work is then grounded on the network perspective of the firm internationalisation process (Johanson & Mattsson, 1988) and is motivated by case studies’ evidence showing that the success of services firms in exporting is strictly related to the economic environment in which they operate and, especially, to information externalities spurring from their relationship with customers (Bell, 1995; Coviello & Munro, 1997). Although case studies yield much information and describe in detail the firm internationalisation experience, evidence based on large firm-level samples is fundamental to understand the systematic export propensity determinants for services firms and thus generalising and extending across firms and services activities the insights suggested by single cases (Javalgi et al., 1998).

Despite the fact that vertical interdependence between buyers and suppliers is not specific to service provision (Martin, Swaminathan, & Mitchell, 1998) and vertical backward linkages in general constitute an important channel through which spillovers occur (Giroud, 2012; Javorcik, 2004),<sup>5</sup> services firms, compared to manufacturing ones, face higher export entry costs and could particularly benefit from spillovers through vertical linkages. The export experience of customers based in the manufacturing sector could therefore ease services firms’ access to the export market through different channels. Internationalised customers may provide strong testimonials abroad, they may represent an informal bridge to set up relationships with new foreign customers and they may transfer precious information necessary for the adaptation of services to the foreign markets.

In order to assess the significance and importance of such spillovers through backward linkages we estimate a probit model for the export status of Italian services firms by making use of the 2001–2003 CAPITALIA survey. From the survey design we are able to exactly identify cross-border exporters. Our sample covers

several different services industries and mostly concerns firms providing information-intensive services whose internationalisation mode increasingly entails cross-border export activities (Ball et al., 2008; Rodriguez & Nieto, 2012) and requires important internal and relational resources (Hitt, Bierman, Uhlenbruck, & Shimizu, 2006). The data we use are therefore particularly suitable for the analysis of cross-border service trade determinants. Turning to our measure of spillovers through backward linkages, it is built by combining national input–output coefficients and the extent of export openness in downstream manufacturing sectors. This measure also reflects the relevance of the geographical proximity to the customer in facilitating interaction and increasing the chance of benefiting from spillovers stemming from customers’ export activity.

While most of the literature on service exports has mainly focused on service multinationals’ international expansion and on their role in foreign markets, our study intends to contribute to the international business studies literature by providing systematic evidence on cross-border service exports determinants. More specifically, we generalise the existing evidence from case studies on the importance of buyer–supplier relationships for services firms’ cross-border exports across several BS sectors by exploring the importance of the relationship with international manufacturing customers for the BS firms export activity.

Our research aims at carrying important implications for international business practices as well: if export spillovers through vertical linkages with manufacturing customers significantly and systematically ease the BS firms’ export activity, BS firms’ managers wanting to expand their sales abroad should be concerned about joining networks with internationalised customers to develop the necessary relational capital to enter foreign markets, regardless of the BS supplied.

By highlighting the relevance of the connection between two parts of the economic system – manufacturing and services – that are becoming more and more intertwined (Pla-Barber & Ghauri, 2012), our study also contributes to the on-going policy debate on countries’ development prospects. If the export performance of the service sector is related to the competitiveness of the manufacturing one, the latter’s productivity performance may importantly affect the development and internationalisation prospects of the former.

The work is structured as follows: Section 2 presents the background of our work and highlights the testable hypothesis, Section 3 describes our sample and our empirical approach and presents the results and Section 5 discusses the findings and concludes.

## 2. Theoretical background and hypothesis

### 2.1. Spillovers through backward linkages in the service firm internationalisation literature

The traditional view of firm internationalisation hinges on the idea that exporting is a difficult task that has to be learned. A strand of literature has depicted firm internationalisation as an incremental process of acquisition of experiential knowledge first in closer markets to later move to far-off destinations (Johanson & Vahlne, 1977). The network approach challenges and complements this view by highlighting how information externalities springing from the firm’s network may foster and ease its export activity (Axelsson & Johanson, 1992; Johanson & Mattsson, 1988). The firm’s network is the socio-economic system where the firm operates and includes all the relationships with its suppliers, competitors and customers. Within the network, both economic and non-economic exchanges are important, and both potential and actual relationships matter,

<sup>4</sup> Buckley, Pass, and Prescott (1999), instead, offer a conceptual framework on the comparison between manufacturing and services.

<sup>5</sup> In the context of the role of MNEs in global supply chains Hatani (2009) also explores the possibility of spillover interception and finds that excess inward FDI could hamper the transmission of technological spillovers from foreign firms to the domestic economy.

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