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Inward–outward connections and their impact on firm growth

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ABSTRACT

Firms can internationalize via two types of operations: inward (related to international supply operations) and outward (related to serving or selling in foreign markets). This paper analyzes variations in growth for firms that adopt different international strategies: those that perform only one type of international operation, and those that undertake both types simultaneously. The study starts from the premise that connections exist between inward and outward operations, connections that give access to related and diverse knowledge. Based on a sample of European SMEs from different sectors, the empirical findings indicate that undertaking inward and outward operations simultaneously exerts a greater positive effect on turnover growth than performing just one type of international operation. This simultaneous effect is significantly higher when these operations take place in the same foreign country. The findings provide support for the idea that the acquisition of country-specific knowledge allows firms to boost sales growth.

1. Introduction

Many firms decide to internationalize when in search of a way to improve performance (Lu & Beamish, 2001, 2006; Pangakar, 2008; Zahra, Ireland, & Hitt, 2000; among others). Exposure to international markets allows them to develop capabilities that can feed further growth (Lu & Beamish, 2006; Sapienza, Autio, George, & Zahra, 2006). Specifically, internationalization exposes firms to fresh and diverse ideas; it provides them with a broader learning opportunity and the ability to develop new skills and augment existing capabilities that are not available to purely domestic firms (Hitt, Hoskisson, & Kim, 1997; Kim, Hwang, & Burgers, 1993). A look at the literature, however, reveals that findings on the relation between internationalization and performance are contradictory (Contractor, Kundu, & Hsu, 2003; Hitt, Bierman, Uhlenbruck, & Shimizu, 2006; Qian, Li, Li, & Qian, 2008), and also specifically when it comes to the relation between internationalization and growth (Lu & Beamish, 2006; Reuber & Fischer, 2002; Westhead, Wright, & Ucbasaran, 2001). These inconclusive findings may be because internationalization also brings cost disadvantages that outweigh its potential benefits (Ruigrok & Wagner, 2003). Many of the difficulties associated with international markets are due to a lack of knowledge (Eriksson, Johanson, Majkgard, & Sharma, 1997, 2000). Firms, though, can mitigate the problems of operating abroad by accumulating this missing knowledge (Liesch & Knight, 1999).

Firms implement their internationalization strategies via two types of operations: outward and inward (Fletcher, 2001; Hätönen, 2009; Welch & Luostarinen, 1993; Welch, Benito, & Petersen, 2007; among others). Previous research has typically concentrated on outward or inward operations individually to examine how firms accumulate knowledge (Blomstermo, Eriksson, Lindstrand, & Sharma, 2004; Bozarth, Handfield, & Das, 1998; Grosse & Fonseca, 2012). Most studies have focused on international strategies based on developing outward operations, which are related to selling products or services in foreign markets through exporting, contractual agreements or foreign direct investment (FDI) in overseas subsidiaries to serve foreign markets. Among the benefits generated by outward operations, entry into foreign markets allows firms to gain knowledge that offers opportunities for growth and improved firm performance (Pangakar, 2008). Firms may also internationalize via inward operations, however. These operations are related to obtaining inputs in foreign markets via importing, contractual collaborations or FDI (Fletcher, 2001; Welch et al., 2007). Although they can open the door to enhanced resources (such as valuable knowledge) that provide a competitive advantage and greater growth (Hessels & Parker, 2013), they were typically seen as being routine and lacking in strategic implications. This led to the

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belief that their advantages were limited to questions of cost (Karlsen, Silseth, Benito, & Welch, 2003) and meant that they were usually given less attention in the internationalization literature. Recently, however, researchers have identified strategic reasons for inward operations, such as their potential role in boosting innovation results (Nieto & Rodríguez, 2011) and ultimately firm performance (Chiao, Yu, Li, & Chen, 2008; Hessels & Parker, 2013).

Some research has also analyzed the existence of inward–outward connections and how inward and outward operations are linked, influence each other and promote the sharing of knowledge (Karlsen et al., 2003; Korhonen, Luostarinen, & Welch, 1996; Welch & Luostarinen, 1993). A gap in the literature exists, however, as research considering how internationalization strategies featuring simultaneous inward and outward operations affect the internationalization-performance relation is missing. Given this situation, the following research question emerges: Are there different effects on growth when firms undertake both inward and outward activities and when they just undertake one type of operation? Specifically, this study explores whether the combination of inward and outward operations in internationalization strategies may help firms to achieve greater growth than when they perform just one type of international operation. An examination of the organizational learning literature helps us to answer this question. This literature posits that it is crucial for firms to acquire and share knowledge (Levitt & March, 1988), with international firms needing to transfer knowledge due to the demands of globalization (Argote & Miron-Spektor, 2011). Inward and outward operations give access to different types of experiential knowledge from different sources. Undertaking both operations simultaneously, then, may allow firms to increase the diversity, relatedness and complementarity of their experiential knowledge. And access to this knowledge has been related to an increase of the absorptive capacity of the firm (Eriksson & Chetty, 2003; Kostopoulos, Papalexandris, Papachroni, & Ioannou, 2011; Yao, Yang, Fisher, Ma, & Fang, 2013), which ultimately affects firm performance (George, Zahra, Wheatley, & Khan, 2001; Tsai, 2001).

This work sets out to contribute to the literature in different ways. First, the paper adds to the inward–outward connections literature by analyzing the impact of performing simultaneous operations on firm growth (previous research focuses on internationalization patterns or the effect of one type of operation on the intensity of the other). The work extends studies that highlight the importance of considering complementarities that may arise between different international activities and goes beyond the individual advantages of accumulating knowledge that one or other operation can offer individually. In this way, the paper extends the typical analysis of the impact of outward operations on performance (Brouthers, Nakos, Hadjimarcou, & Brouthers, 2009; Hitt et al., 1997; Pangakar, 2008; Qian et al., 2008; Zahra et al., 2000; among others). In particular, it advances our understanding of the synergies and complementarities that could derive from undertaking inward and outward operations simultaneously (Bertrand, 2011), insofar as they could positively affect firm performance (Cassiman & Golovko, 2011). Moreover, it feeds into the organizational learning literature by considering the benefits derived from accumulating knowledge from different domains, which increases the potential paths for seeking and combining knowledge (Taylor & Greeve, 2006). In fact, we draw on the notions of absorptive capacity (Cohen & Levinthal, 1990) to build a theoretical argument on why undertaking inward and outward operations simultaneously is important for increased growth. Organizational learning scholars in the international arena have explained the effect of accumulating and transferring knowledge on performance by considering aspects such as the geographic scope and the pace or rhythm of the firm's international activity (Barkema & Drogendijk, 2007; Vermeulen & Barkema, 2002). Less research, however, has explored this relation by analyzing the acquisition of knowledge from international markets through operations on the supply and/or demand side. By tapping into the concepts of relatedness, diversity and complementarity of the knowledge acquired, this paper covers this gap to extend our understanding of how the growth rate of firms may differ depending on the types of operations undertaken in their international strategies. The analysis is conducted on a large sample of European SMEs. This sample is especially suitable for examining this relation as knowledge is fundamental for the growth of these firms (Mejri & Umemoto, 2010) and growth is in itself a fundamental objective (Golovko & Valentini, 2011; Lu & Beamish, 2006). Furthermore, the richness of the available data may make it possible to generalize the results to different national and sectoral contexts. This is particularly important given that many of the studies examining inward–outward connections are conceptual or based on case studies (Holmlund, Kock, & Vanyushyn, 2007). A clear need, then, exists to widen the literature via studies based on large samples that permit generalizable results (Fletcher, 2001). Likewise, the examination of a variety of inward operations (i.e., imports, contractual collaborations, and FDI to acquire inputs) and outward operations (i.e., exports, contractual collaborations and FDI to serve foreign markets) allows this paper to go beyond other studies that focus solely on importing and exporting (Holmlund et al., 2007; Korhonen et al., 1996).

The paper is structured in the following way. The next section considers the theoretical aspects of knowledge in the internationalization process, along with the relation between internationalization and firm performance. The following sections then go on to formulate the research hypotheses and describe the methodology used. The final sections of the work analyze and discuss the results and their implications, closing with some limitations and lines for future research.

2. Literature review and hypotheses

2.1. Knowledge accumulation through international operations

Most of the literature indicates that the ability to create and replicate new knowledge via expanding markets has an impact on firm growth (Kogut & Zander, 1993). Not all types of knowledge, however, share the same potential for generating a competitive advantage. Researchers distinguish between objective and experiential knowledge (Penrose, 1959), with the latter being more complex to transfer both within firms and between them because it is tacit and acquired by experience (Grant, 1996). As Johanson and Vahlne (2006) posit, experiential knowledge is what provides the framework for perceiving and formulating opportunities.

Firms can tap into different types of experiential knowledge. Firms accumulate experiential knowledge of internationalization by being active in foreign markets. This experiential knowledge is considered to be more important than objective knowledge for international strategies (Blomstermo et al., 2004; Eriksson et al., 1997; Johanson & Vahlne, 1977). Some research divides this international experiential knowledge between: (i) *internationalization knowledge* – referring to general knowledge of how firms develop and execute their internationalization strategies; identify and evaluate opportunities; screen country markets, etc.; and (ii) *market knowledge* – including both specific knowledge of clients and competitors in the foreign market (*business knowledge*), as well as how institutions operate in the foreign market (*institutional knowledge*) (Eriksson et al., 1997). Another type of experiential knowledge that is relevant for international activities is *technological knowledge* – referring to the knowledge required to produce goods and services (Bohn, 1994; Nordman & Melén, 2008). Firms