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Leadership positioning among U.S. firms investing in China

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ABSTRACT

This study investigates leadership positioning by U.S. firms in China using the awareness, motivation, capability (AMC) perspective. We define leadership as first in industry to invest in China, and find that leaders have characteristics associated with higher AMC, evidenced by pre-existing multinational experience, higher product market orientation, smaller scale of operations, and higher input cost structure. Notably, the motivation to lower input costs and the prior capability in multinational operations mattered only for the first wave of firms leading industry investment earlier in time, while firms with smaller scale of operations exhibited a preference to lead investment in less popular provinces. Overall, these results provide a unique view on how AMC characteristics influence international investment decisions, suggesting that firms both strategically lead and strategically follow. In additional analysis, we examine how leaders and followers positioned themselves with respect to ownership, and find that leaders were more likely to choose entry modes that offered ownership control over flexibility, consistent with internalization theories.

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1. Introduction

In 1983, American Motors Corp. established the first automotive, and the largest industrial joint venture in the People's Republic of China. At the time, Chairman and CEO Paul Tippett declared: "*The days when a major company could hope for long-term international success while limiting itself to domestic production and exports are gone*" (Pelfrey, 1983). Like many U.S. companies facing competitive pressures in their concentrated industry segments, American Motors Corp. saw the economic liberalization reforms that began with China's Open Door Policy in 1979 as a way to maintain and grow its market share.[1] Yet the company did not have significant international experience; it relied instead on its four-year partnership with Renault in France to "*set the pattern for future international manufacturing partnerships*" (Pelfrey, 1983). This model proved inadequate in China in the early 1980s: despite the country's market potential, bureaucratic and economic obstacles left the company's ambitious $51 million joint venture, Beijing Jeep, on the verge of bankruptcy in 1986 (New York Times, June 8, 1986; Mann, 1997).

By comparison, firms with significant international experience, like personal care products company Gillette, placed less emphasis on rapid market penetration and focused on learning how to do business in China while working to establish a reputation and gaining the confidence of Chinese officials. In 1988, Michael C. Hawley, Vice President of Worldwide Operation Services at the Gillette Company explained this strategy as follows: "*The companies that have a lot of international experience have entered China with their eyes open, and they didn't get overly ambitious. They are going along laying the foundation for the future of their company... Gillette is a company that operates 60 factories in 30 different countries around the world. We had the basic ability to mount an operation anywhere in the world, but no one had built any experience in China at all. It was rather hard to set expectations based on anyone else's understanding or information*" (Yoshihara, 1988).

As this anecdotal evidence suggests, the manner in which firms established initial investment presence in overseas markets was an important strategic consideration. Indeed, being the first among industry peers to establish operations in a foreign market can lead to significant advantages in terms of excess profits and market

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[1] Other pioneers in the early 1980s included Coca Cola, Pepsi, Occidental Petroleum, Eastman Kodak, Atlantic Richfield, and Beatrice Companies, among others (New York Times, June 8, 1986).

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share. However, in the presence of environmental uncertainty, the ability to benefit is dependent on characteristics that allow firms to absorb risk. We investigate the likelihood that a firm will be first among industry peers to invest in China, using a theoretical framework based on the awareness, motivation and capability (AMC) paradigm (Chen, 1996; Smith, Ferrier, & Ndofor, 2001). Specifically, we develop and test hypotheses for the relationship between investment leadership positioning and firm characteristics associated with *awareness* of external investment opportunities, *motivation* to exploit them, and *capability* to acquire external assets. In so doing, we provide a novel contribution to the international business literature since the AMC framework has not been previously applied to industry rivalry by domestic firms in foreign markets.

Because China's Open Door Policy served as a time-zero event with respect to foreign direct investment, the country provides a natural experimental setting for the study of how firms strategically position themselves against industry rivals. For the purposes of our investigation, we construct a hand-collected sample of publicly traded U.S. companies investing in China between 1980 and 2005, and track the year, location and entry mode for each firm. We then examine firm characteristics that explain differences between firms that lead industry investment in China and those that follow. We conduct this analysis for the full 26-year sample period and for two separate subsamples, early (1980–1992) and late (1993–2005) entry. Consistent with arguments in Arregle, Miller, Hitt, and Beamish (2013), we also utilize heterogeneity in Chinese province-level characteristics to better evaluate their importance as determinants of entry positioning. As an additional dimension of leadership positioning, we conduct a multinomial probit analysis to explore whether firm-specific internalization advantages influences the choice of entry modes that offer ownership control compared to flexibility.

Our results show that firms leading their industry with investment in China have characteristics associated with higher AMC. For example, industry pioneers have higher marketing-seeking orientation, associated with heightened awareness of, and motivation to exploit, new investment opportunities. They also have multinational experience and asset structures with embedded abandonment options, which provided greater motivation and capability to expand to a foreign market. Notably, leaders are smaller in size, a trait associated with greater motivation to act quickly and aggressively to survive in competitive markets. In additional analysis of entry mode determinants, we find meaningful differences between leaders and followers. Greater asset specificity influenced industry pioneers to choose wholly-owned investment modes over joint venture partnerships, suggesting the need to internalize capabilities as they entered the country ahead of competitors, thus bearing more risk. In contrast, entry mode choices by follower firms were primarily influenced by province- rather than firm-level characteristics.

The rest of the paper is structured as follows. Section 2 provides a theoretical background and Section 3 develops testable hypotheses. Section 4 describes sample construction and provides descriptive statistics of the patterns of expansion by U.S. firms in China. We present our estimation framework in Section 5, empirical results in Section 6, and a concluding discussion in Section 7.

2. Theoretical background

2.1. First mover advantages and disadvantages

The notion that first movers in a new market are able to reap greater economic benefits compared to followers is well documented in the literature. First movers can earn excess profits, higher market shares, and have longer survival rates than followers (Kerin, Varadarajan, & Peterson, 1992; Lambkin, 1988). This superior performance and survival stems from the ability to exploit opportunities for cost efficiencies, technological leadership, preemption of assets, and buyer loyalty (Lieberman & Montgomery, 1988). For example, first movers can capture customers through loyalty to a pioneering brand, and thus enjoy the advantage of high switching costs (Carpenter & Nakamoto, 1989; Schmalensee, 1982). They can preempt assets by securing scarce input resource and advantageous locations in advance of followers (MacMillan, 1983; Prescott & Visscher, 1977). Cost advantages arise from economies of scale and learning through early preemptive investments (Dixit, 1980; Lilien & Yoon, 1990).

Some firms are positioned to benefit most from being first mover, and others have attributes that make them particularly vulnerable to first mover disadvantages (Li, Lam, Karakowsky, & Qian, 2003). Specifically, early investment in foreign markets exposes entrants to political, institutional, technological, and market uncertainty, and also to free-rider effects where leaders create pathways for innovation that followers exploit (Gal-Or, 1987; Lieberman & Montgomery, 1988, 1998; Sorenson, 2000; Zaheer, 1995). Further, in the urgency of securing an apparent competitive advantage, first movers can be vulnerable to early exercise of the real option to wait, unadvisedly committing themselves to irreversible investments (Cottrell & Sick, 2001). Firms that are able to maximize first mover advantages and minimize their costs must therefore possess characteristics that distinguish them from rivals. In this context, both leading and following should be intentional strategic choices.

We are specifically interested in isolating firm characteristics that are associated with being industry first entrant with respect to investment in uncertain new markets. Using a dynamic capabilities perspective, Teece, Pisano, and Shuen (1997) show that successful market penetration is associated with firm attributes such as learning, ability to strategically restructure assets in response to changing market conditions, proprietary technologies, financial capabilities, organizational structure (e.g., focused versus conglomerate), and product market position. Several other studies identify similar firm-specific attributes associated with first mover success such as managerial skill and experience, R&D intensity, marketing intensity, financial capability, and specialized assets (Mitchell, 1991; Murthi, Srinivasan, & Kalyanaram, 1996; Rosenbloom and Cusumano, 1987; Schoenecker, & Cooper, 1998). For example, firms with established experience in one technology have a learning resource advantage to invest in a related new technology ahead of competitors and secure greater market share (Klepper & Simons, 2000). Similarly, greater cumulative organizational learning can provide early access to new opportunities and create barriers to subsequent entry (Spence, 1981).

For firms that strive to be industry leaders, timing is of the essence when launching a strategic initiative to competitive pressures by expanding operations in overseas markets. Chen (1996) identifies *awareness*, *motivation*, and *capability* (AMC) as three key drivers of strategic interaction among rivals, and we find this framework particularly well-suited for identifying firm characteristics that are relevant to first mover success. In the next section, we review the AMC paradigm and then use it to develop testable hypotheses for the likelihood of being first in the industry to invest in China.

2.2. Inter-firm competition and the awareness, motivation, capability framework

A firm's bundle of strengths, weaknesses and strategic opportunities is important in predicting success in inter-firm rivalry and can be evaluated by its degree of *awareness*, *motivation*,

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