



# When does absorptive capacity matter for international performance of firms? Evidence from China



Aiqi Wu <sup>a,\*</sup>, Hinrich Voss <sup>b,1</sup>

<sup>a</sup> Zhejiang University School of Management, 388 Yuhangtang Road, Hangzhou 310058, Zhejiang Province, PR China

<sup>b</sup> Leeds University Business School University of Leeds, Leeds LS2 9JT, UK

## ARTICLE INFO

### Article history:

Received 4 November 2013  
Received in revised form 26 April 2014  
Accepted 12 August 2014  
Available online 2 September 2014

### Keywords:

Absorptive capacity  
China  
Duration of internationalization  
Earliness of internationalization  
International performance

## ABSTRACT

While learning plays an important role in firms' internationalization process, the impact absorptive capacity has on the international performance when considering the timing of the internationalization is still unclear. Our research explores the role of absorptive capacity in international performance of early internationalizing firms and international experienced firms. Combining established theories, we propose opposing effect of absorptive capacity as the learning advantages of newness vanish over time and are replaced by organizational rigidities and inertia. Based on survey data from 162 Chinese firms, our empirical results indicate that the influence of absorptive capacity on international performance becomes stronger when the firm enters foreign market in its earlier stage of life cycle. However, we find that as the learning advantages of newness diminish, so does the effectiveness of high levels of absorptive capacity. Absorptive capacity resources become captured by organizational and operational rigidities and contribute less to firm performance.

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## 1. Introduction

The traditional internationalization process literature has suggested that firms need to approach international expansion with a slow pace and sequentially because firms need to gradually learn about foreign countries (Johanson & Vahlne, 1977, 1990). In contrast, recent international entrepreneurship studies have documented a much earlier international expansion by many firms (Oviatt & McDougall, 1994; Weerawardena, Mort, Liesch, & Knight, 2007; Zhou, Wu, & Luo, 2007), and suggested that firms can be competitive internationally by exploiting market opportunities in foreign countries much earlier in a firm's life cycle (Bals, Berry, Hartmann, & Raettich, 2013). In this context, firms apparently learn and absorb knowledge about foreign countries quicker. The fundamental theoretical challenge remains unanswered whether the effect of *absorptive capacity* is stronger among earlier internationalizers than those firms with long established international operations.

Extant empirical studies provide inconclusive results regarding the relationship of earliness of internationalization and firm

performance. While some studies find a positive relationship between earliness of internationalization and firm performance (Autio, Sapienza, & Almeida, 2000; Blesa & Ripollés, 2008; Schwens & Kabst, 2009; Bloodgood, Sapienza, & Almeida, 1996; Carr, Haggard, Hmieleski, & Zahra, 2010; Fernhaber & Li, 2010; Kropp, Lindsay, & Shoham, 2006), others report a negative relationship (Vermeulen & Barkema, 2002), or a none significant relationship (McDougall & Oviatt, 1996; Zahra & Garvis, 2000; Khavul, Pérez-Nordtvedt, & Wood, 2010). One of the reasons for these contradictory results is that the effect of earliness of internationalization on firm performance cannot automatically occur and may depend on the firm's capacity to absorb new knowledge and practices into its operations (Cohen & Levinthal, 1989, 1990; Forsgren, 2002).

While the importance of absorptive capacity in learning is clear, whether absorptive capacity *always* plays an important role in international performance of firms is unclear. While the international entrepreneurship stresses the importance of flexibility, i.e., rapid identification and absorption of knowledge, the traditional internationalization process literature emphasis the steady, low-paced accumulation of knowledge. We are thus left with two seminal perspectives on the internationalization of the firm which both only partially account for the role of absorptive capacity. Generally speaking, absorptive capacity enables the firm to explore and exploit technology and market opportunities at home and overseas.

\* Corresponding author. Tel.: +86 0571 8820 6856; fax: +86 0571 8820 6856.

E-mail addresses: [wuaiqi@zju.edu.cn](mailto:wuaiqi@zju.edu.cn) (A. Wu), [hv@lubs.leeds.ac.uk](mailto:hv@lubs.leeds.ac.uk) (H. Voss).

<sup>1</sup> Tel: +44 133 3432633.

To fill this research gap, we draw on the organizational learning theory (Cohen & Levinthal, 1989, 1990) and explore how the firm's level of absorptive capacity affects the international performance of both early internationalization firms and international experienced firms. We define *firm international performance* as the year-on-year growth in foreign sales of a firm (Prashantham & Young, 2011). Specifically, we first investigate the role of absorptive capacity in international performance of early internationalizing firms from China, the world's second largest economy (World Bank, 2014). Our work in the context of Chinese firms helps to advance our knowledge about the absorptive capacity-international performance relationship among early internationalizing firms because extant studies largely focus on developed economy firms and pay little attention to emerging economy firms (cf., e.g. Oviatt & McDougall, 1994; Burgel & Murray, 2000; Jones, Coviello, & Tang, 2011).

Second, we investigate whether absorptive capacity provides persistent performance advantages to the firm that had operated in foreign markets for a long period of time. Extant studies explored the learning and performance advantage of newness in young ventures (Autio et al., 2000; Khavul et al., 2010; Zhou, Wu, & Barnes, 2012). However, according to the learning liability of aging argument (Barron, West, & Hannan, 1994; Sørensen & Stuart, 2000), experiences or established routines that accumulated in firms' international operations impede their learning capability in new environments because their accumulated international experiences make them less flexible compared to international new ventures that operate internationally only a short time. Thus, the learning advantages of newness (Autio et al., 2000) will decay as firms continue their international operations. The level of absorptive capacity becomes thus less important the longer the firm operates internationally. Therefore, the unknown is how the relationship between absorptive capacity and international performance of firms is influenced by how early they internationalize and how long they have operated in foreign markets.

In the next section, we present the theoretical background of the research and develop our hypotheses. We then describe our methodology and present our results. Finally, we discuss our results and present conclusions and managerial implications.

## 2. Theoretical background and hypotheses

We emphasize a firm's absorptive capacity and relate it to the timing of internationalization, and the duration of internationalization as critical moderators of the outcomes of international performance. We highlight these two endogenous variables because they are central to internationalization and learning theories (Sapienza, Autio, George, & Zahra, 2006; Forsgren, 2002). We first introduce the concept of absorptive capacity and the role of absorptive capacity in organizational learning. We then relate the role of absorptive capacity in international performance to the internationalization process and the international entrepreneurship theories in order to develop our hypotheses.

### 2.1. Absorptive capacity

Being able to learn about market demands and structures and from this being able to anticipate current opportunities and future developments that need to be further explored are crucial traits in any business. Absorptive capacity is thus the ability to recognize the value of new, external information, to assimilate it and apply it for commercial purposes (Cohen & Levinthal, 1990) to sustain a competitive advantage (Zahra & George, 2002). Studies suggest that absorptive capacity enable a firm to successfully learn in foreign markets and consequently achieve superior international performance (Zahra & Hayton, 2008). The development of

absorptive capacity depends on the prior existence of related knowledge (Cohen & Levinthal, 1990). That is, international learning is effective when a firm has related knowledge stock. Therefore, studies emphasize the importance of international experiences in a firm's international learning and performance (Delios & Beamish, 1999).

Both the traditional internationalization process theory and the international entrepreneurship theory suggest that knowledge is indispensable for successful international expansion (Johanson & Vahlne, 1977, 1990; Oviatt & McDougall, 1994, 2005; Forsgren, 2002) and thus the absorptive capacity of the firm. But they approach and conceptualize it differently. The internationalization process model emphasizes the behavioral tendency of firms to avoid uncertainty and thus to delay the internationalization. Possessing limited international experience and knowledge, these firms cautiously seek to gain know-how about foreign markets and to understand the market's business environment. Experiential knowledge of foreign markets induces the firm to commit resources to them. A firm's increased international experiences help to decrease its perceived uncertainty associated with the foreign market commitments and increase its perception of opportunity in foreign markets (Johanson & Vahlne, 1977, 1990).

Studies that have found firms to venture into foreign markets in the early stage of their life cycle (Oviatt & McDougall, 1994; Fan & Phan, 2007; Zhou et al., 2007; Jones et al., 2011) emphasize the leveraging and developing of advantages that may be afforded through early internationalization. The absorptive capacity is part of the learning advantages of newness (Autio et al., 2000) according to which the flexibility and adaptability of early internationalizers allows them to assimilate learn knowledge, enabling them to pursue rapid growth in foreign markets and perform well. Thus, the phenomenon of early internationalization has challenged the internationalization process theory for how these firms acquire, process, and utilize knowledge about foreign markets and their characteristics (Sapienza et al., 2006).

### 2.2. Effects of absorptive capacity and early internationalization on international performance

Knowledge was at the core of the process models of internationalization (Forsgren, 2002), which suggests that lack of foreign market knowledge is an impediment to international expansion. As a result, the internationalization occurred through a process of incremental stages as the firm gradually accumulated foreign market knowledge (Johanson & Vahlne, 1977, 1990). Early internationalizers often have limited knowledge about foreign markets, culture and institutions. Thus, they need to actively search for foreign knowledge in order to survive and grow in complex and dynamic foreign markets. Learning is the basic strategy for knowledge acquisition and creation (Autio et al., 2000; Cohen & Levinthal, 1990) and this helps firms to overcome their liabilities of foreignness (Hymer, 1976; Zaheer, 1995) and newness (Stinchcombe, 1965). We argue that while the flexibility and entrepreneurial nature associated with early internationalization provides opportunities to access external new knowledge from international markets, organizational absorptive capacity enables firms to successfully achieve their international learning and performance advantage.

Studies suggest that early internationalizers can learn and grow in international markets faster than older entrants (Autio et al., 2000) though they may often lack international knowledge stocks or only have narrow skill base (Zahra, 2005). For example, Oviatt and McDougall (1994) have drawn attention to the potential advantages international new ventures have, relative to their established competitors, in learning about markets and competition. Furthermore, Autio et al. (2000) argue that if firms venture

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