Journal of World Business 51 (2016) 391–403

Contents lists available at ScienceDirect

Journal of World Business

journal homepage: www.elsevier.com/locate/jwb

The effect of social networks and dynamic internationalization capabilities on international performance

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ARTICLE INFO

Article history:
Available online 18 August 2015

Keywords:
Social networks
Dynamic capabilities
International performance
Mediation
Partial least square structural equation modeling (PLS-SEM)

ABSTRACT

This article explores the relationship between social networks and dynamic internationalization capabilities (DICs), and their impact on the international performance of small and medium-sized firms (SMEs) in low-tech industries. We distinguish between exploitative DICs (threshold and consolidation capabilities) and explorative DICs (value-adding and disruption capabilities). Our results, which are based on a sample of small and medium-sized Portuguese exporters, indicate that social networks are a relevant antecedent of exploitative and explorative DICs, and that consolidation and disruption capabilities positively affect international performance. Multiple mediation analysis confirms these relationships. The article concludes with a discussion of implications for research and practice.

1. Introduction

In this era of globalization, firms find themselves competing internationally, irrespective of their size. In attempts to grow and succeed in the global marketplace, the ability to leverage social and business networks has become critical (Vasilchenko & Morrish, 2011; Eberhard & Craig, 2013). Networks are particularly important for small and medium-sized firms (SMEs), as these firms typically face resource constraints and lack the knowledge needed for internationalization (Gilmore, Carson, & Rocks, 2006; Madsen & Servais, 1997). Studies show that network ties have a significant influence on firms' internationalization (Blyler & Coff, 2003; Ciravegna, Majano, & Zhan, 2014; Ellis & Pecotich, 2001; Ellis, 2011; Fernhaber & Li, 2013) as they provide paths to entry into international markets, help screen and evaluate potential partners, and reduce exchange risks through the creation of mutual trust (Larson, 1992).

Several studies link networks to international performance. They suggest that networks can help accelerate expansion processes and overcome liabilities of foreignness (Hymer, 1976) and outsidership (Johanson & Vahlne, 2009). For SMEs, the ability to network effectively is itself a crucial capability in the sense that it generates value by creating and accessing a variety of resources, such as new knowledge (Hoang & Antoncic, 2003). Given the current pace of change, SMEs need to continually create, adapt, and reconfigure their resources and network ties to stay competitive (Eberhard & Craig, 2013; Naudé, Zaefarian, Tavani, Neghabi, & Zaefarian, 2014), i.e., they need to develop dynamic capabilities (DCs). DCs have been defined as a set of specific, identifiable processes (Eisenhardt & Martin, 2000; Li & Liu, 2014; Narayanan, Colwell, & Douglas, 2009), a definition we follow in this article.

While previous research has investigated DCs both in large and in entrepreneurial companies (e.g., Ahrend, 2014; Zahara, Sapienza, & Davidsson, 2006), few studies have explicitly analyzed small as opposed to young entrepreneurial firms, or considered different types of firms to see which firms are more likely to benefit from the development and utilization of DCs. For example, Teece (2007) states that DCs are particularly relevant for multinational firms in global markets, while Kale and Singh (2007) mainly address large firms.

Most of the extant research on firm capabilities documents the positive impact of DCs on performance (Gudergan, Devinney, Richter, & Ellis, 2012; Wang & Ahmed, 2007). The empirical evidence confirms that DCs play an important role in firms' long-term survival and success (Lin & Wu, 2014; Pavlou & El Sawney, 2011; Protogerou, Caloghirou, & Lioukas, 2011; Rindova & Kotha, 2001). Blyler and Coff (2003) propose that social networks among individuals facilitate the development of new capabilities by promoting a constant flow of information from various external and internal sources. These capabilities, in turn, affect performance. Hsu and Wang (2012) propose a model to explain how performance is influenced by intellectual capital (including relational capital) through DCs. Lew, Sinkovics, and Kuivalainen

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http://dx.doi.org/10.1016/j.jwb.2015.08.001
1090-9516/

(2013) are among the few that explicitly argue that networks support a specific type of capabilities, i.e., exploratory capabilities, that drive market performance. Griffith and Harvey (2001) study global dynamic capabilities in international business networks, and suggest that powerful positions in networks enable organizations to develop dynamic capabilities and, thereby, enhance performance.

Despite these insights, how SMEs' networks drive the development of different types of capabilities, and how networks and capabilities affect international market performance remains under-researched (Hsu & Wang, 2012). To address this gap in the literature, this study considers the following research questions. First, drawing upon the typology proposed by Prange and Verdier (2011), this study analyzes how dynamic internationalization capabilities (DICs) can be operationalized by using four underlying dimensions of capabilities (threshold, consolidation, value-adding and disruption). Second, we investigate how social-network relationships (SNRs) contribute to improving and extending existing competencies, processes, and technologies (exploitative capabilities), and to renewing and modifying the firm's resource base (explorative capabilities) for SME internationalization. Third, we analyze how different DICs influence SME internationalization performance.

To answer these questions, we conducted an empirical survey of SME Portuguese exporters operating in different sectors such as, textile, clothes, leather, and footwear. These industry segments have internationalized in the recent past and are operating under similar institutional conditions, which minimize the bias caused by governmental influences and technological intensity. In addition, few studies to date have focused on low-tech sectors when investigating DCs (e.g., Evers, 2011; Protogerou, Caloghirou, & Karagouni, 2013). Therefore, we contribute to the literature by developing an integrative model of the effects of SNRs, DICs, and international performance within the context of internationalization theory. Additionally, we propose a new operationalization of DICs in the context of SMEs.

Given the specifics of SMEs, in which decision-making and networking are often in the hands of top managers or owner-entrepreneurs, we focus on the top-management level, though DC development may also occur through interactions between top managers and various layers of lower management (e.g., Augier & Teece, 2009; Narayanan et al., 2009).

Our findings contribute to research on developing DICs in SMEs in that we find that various dimensions of DICs may have a distinct mediating impact on international performance (Augier & Teece, 2007; Knudsen & Madsen, 2002; Luo, 2000).

The structure of the paper is as follows. Based on a review of the extant literature, we develop a set of theoretically grounded hypotheses for empirical testing. Subsequently, we discuss our sample data and method before presenting the results of our PLS-SEM estimations. We conclude with a discussion of the findings, some of the study's limitations, and implications for practice and theory.

2. Theoretical background and hypotheses

2.1. Social networks and international performance

On the basis of insights drawn from social-network theory, researchers in international business have emphasized the importance of networks for performance outcomes (e.g., Naudé et al., 2014; Peng & Luo, 2000), and the relevance of owner-managers' networks (Watson, 2007). "Social networks" refer to the ability of certain individuals to extract benefits from their social structures, connections, and memberships (Davidsson & Honig, 2003) through privileged connections.

The advantages of networks for internationalization have been widely discussed. By working together and exchanging information, firms can share the risks of failure and trepidation associated with entering foreign contexts (Chetty & Patterson, 2002). Yli-Renko, Autio, & Sapienza (2001) argue that firms mainly use external relationships for knowledge acquisition and learning and these relationships help to access tacit and strategic knowledge for international activities (Ciravegna, 2011; Manolova, Manev, & Gyoshev, 2010; Naudé et al., 2014). In social networks, it is especially the experience and knowledge of the top decision-makers that contributes to the development of the firm's asset base and new operational capabilities (Leonidou, Katsikeas, & Piercy, 1998; Madsen & Servais, 1997; Oviatt & McDougall, 1995). This suggestion is in line with research that views managerial and social ties as having important implications for strategic choice and performance (Geletkanycz & Hambrick, 1997; Naudé et al., 2014; Watson, 2007).

2.2. The role of dynamic internationalization capabilities in the social network-performance relationship – a mediation model

2.2.1. Dynamic internationalization capabilities

Resources and capabilities, such as network capabilities, need to be leveraged through dynamic capabilities (Hsu & Wang, 2012). The dynamic capability view (DCV) of strategy, which takes this statement as its start, argues that firms are challenged to modify their resource base by enhancing, revising, or reconfiguring existing resource bundles and capabilities (Helfat & Peteraf, 2003; Zahara et al., 2006). While growing in number, studies of DCs still lack a commonly accepted definition of "dynamic capability" (Barreto, 2010; Eisenhardt & Martin, 2000; Teece, Pisano, & Shuen, 1997; Winter, 2003). Originally, the concept related to a firm's ability to integrate, build, and reconfigure internal and external competences in order to address rapidly changing environments (Helfat et al., 2007; Teece et al., 1997). Others have defined DCs as routines in the form of learned and stable patterns of collective actions directed at the development of operating routines (Zollo & Winter, 2002). The majority of authors have adopted a process definition (Li & Liu, 2014) whereby DCs are viewed as a set of specific, identifiable processes (Eisenhardt & Martin, 2000; Narayanan et al., 2009).

Some authors ascribe a major role to DCs in volatile environments (Teece, 2007), whereas others argue that DCs are also important in moderately dynamic environments (Eisenhardt & Martin, 2000) or even exist when firms experience low rates of change (Zollo & Winter, 2002). Still others implicitly assume that context is irrelevant for the development of DCs (Makadok, 2001) or that context does not play a vital role (e.g., Blyler & Coff, 2003; Danneels, 2008). We agree with Winter (2003), who proposes that the value of DCs is context-dependent, although the impact of contextual factors may play a lesser role in our study due to the stability of the textile industry relative to other environments.

On the basis of March's (1991) notions of "exploitation" and "exploration", we argue that two categories, or bundles, of dynamic internationalization capabilities (DICs)—exploitative and explorative—have an impact on international performance. Tallman and Fladmore-Lindquist (2002) refer to this dichotomy by suggesting that firms engage either in capability leverage or exploitation, as well as capability building. Luo (2002) and Madsen (2010) argue that firms face a dilemma, as they must decide whether to focus on developing new capabilities, or on improving existing activities and current operations. Prange and Verdier (2011) distinguish among four types of process capabilities: threshold capabilities focus on doing the same things more effectively and relate to the ability of the firm to organize so as to function competitively in different environments; consolidation