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The drivers of international corporate entrepreneurship: CEO incentive and CEO monitoring mechanisms

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ABSTRACT

This study examines international corporate entrepreneurship associated with new product lines and new geographic markets. Drawing upon agency theory and the corporate entrepreneurship literature, we posit that aligning CEO incentives with shareholder interests and adopting CEO monitoring mechanisms will promote international corporate entrepreneurship. We test the hypotheses using 277 U.S.-based manufacturing firms during the period from 2003 to 2009. Our findings highlight how various governance mechanisms such as a CEO's compensation linked to the long-term performance of the firm, the values of the CEO's shareholding, independent board leadership, and the representation of outside directors influence international corporate entrepreneurship of existing firms.

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1. Introduction

Why do the CEOs of some established firms choose to engage in risky international entrepreneurial activity, while others do not? International entrepreneurship research continues to flourish (Jones, Coviello, & Tang, 2011; Keupp & Gassmann, 2009) with scholars investigating the innovative, proactive, and risk-seeking behavior of firms in international markets (Hoskisson, Covin, Volberda, & Johnson, 2011; McDougall & Oviatt, 2000). However, recent research in this field has tended to concentrate on born-global firms that have been involved in value-added activities in international markets from their inception (Oviatt & McDougall, 1994). The international entrepreneurial activity of existing firms has been overlooked (Keupp & Gassmann, 2009).

In response, we consider what drives the international entrepreneurial activity of existing firms, by looking into risky international expansion. Internationalization is a complex and costly process: firms must thoroughly investigate opportunities, build the infrastructure necessary to expand, and develop and execute multiple strategies (George, Wiklund, & Zahra, 2005). Similar to the conceptualization of international corporate entrepreneurship adopted in the extant literature (e.g., Naldi, Achtenhagen, & Davidsson, 2014), we define international corporate entrepreneurship as establishing new foreign subsidiaries, the product lines of which are beyond the spectrum of the existing product lines in the firm's home market and the locations of which are beyond the spectrum of the existing host countries. In other words, international entrepreneurial activity is associated with both *new* product lines and *new* geographic markets.[3]

Most previous research on international entrepreneurship relies on traditional theories of international business (Keupp & Gassmann, 2009); however, this may not provide a complete understanding of international entrepreneurial activity. According to traditional theories of multi-national enterprises (MNEs), such as the industrial organization theory of MNEs (Hymer, 1976), product lifecycle theory (Vernon, 1966), internalization theory (Buckley & Casson, 1976), and the theory of internationalization (Johanson & Vahlne, 1977), the main reason firms enter international markets is to extend capabilities or competencies

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[3] We note that Naldi et al. (2014) defined international corporate entrepreneurship (ICE) as "an international firm's expansion into new foreign markets *or* into existing foreign markets by providing new products/services to existing customers (p. 4)." In this sense, our definition of ICE is narrower and more conservative.

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developed in home markets into foreign markets. On the other hand, in this study, we associate international entrepreneurial activity with new foreign subsidiaries that are established in new host countries and that develop product lines that are not the same as existing product lines in home markets.

In addition to viewing operations in foreign markets as capability leverage, researchers now also recognize such operations as entrepreneurial opportunity-seeking measures (e.g., Jones & Coviello, 2005; Lu & Beamish, 2001). This line of research equates entrepreneurial activity to entering foreign markets in new host countries in which a firm's foreign subsidiaries are located (Birkinshaw, Hood, & Johnson, 1998; Rugman & Verbeke, 2001). New foreign subsidiaries may develop and operate new product lines in foreign markets either to better serve local needs or to build the capabilities of their firms in a global setting (Dunning & Lundan, 2008). These new foreign subsidiaries are located in the midst of diverse foreign environments, which provide significant opportunities to leverage local resources to build the MNE's capabilities (Autio, George, & Alexy, 2011).

However, firms that conduct business abroad experience liabilities of foreignness; consequently, they incur higher costs than their local competitors. Thus, these new foreign subsidiaries may need to strive harder to become familiar with, or adapt to, foreign environments (Hymer, 1976; Zaheer, 1995). International entrepreneurial activity also creates greater uncertainty and, consequently, additional cost, because firms cannot use existing capabilities developed in their home markets; rather, they must develop new capabilities in new foreign markets (Barkema & Drogendijk, 2007; Cohen & Levinthal, 1990). In short, international entrepreneurial activity is more likely to fail and take longer to perform satisfactorily. As such, the risk preference of the chief executive officer (CEO) is likely to influence whether activities are undertaken or not (Acedo & Jones, 2007). CEOs tend to be risk-averse, given their investment in firm-specific human capital and their concern about job security (Eisenhardt, 1989), and may not favor increased international entrepreneurial activity. What then makes a CEO more entrepreneurial and encourages risk-taking behavior?

Drawing on agency theory and the corporate entrepreneurship literature, we posit that two mechanisms can help align CEO behavior with the interests of shareholders and encourage CEOs to undertake corporate entrepreneurial activity in international markets. These two mechanisms are (i) aligning CEO incentives and (ii) monitoring CEOs. Specifically, we examine the effects of CEO compensation structure, the value of the CEO's shareholding, independent board leadership, and the representation of outside directors. We empirically test our hypotheses using a panel dataset from 277 U.S.-based manufacturing firms with 978 observations from 2003 to 2009.

We aim to make the following contributions to the theory and practice of international corporate entrepreneurship. First, we extend extant research by investigating the international entrepreneurial activity of existing firms, rather than the behaviors of born-global firms that are defined by a narrower view of international entrepreneurship (Keupp & Gassmann, 2009). Our work also facilitates better understanding of international entrepreneurial activity from the perspective of a firm as a whole, rather than from the standpoint of a subsidiary. Our findings also reveal the integration that exists between the fields of corporate governance and international entrepreneurship by using agency theory to explain international entrepreneurial activity. Finally, our study of internationalization is an important opportunity to enhance our understanding of corporate entrepreneurship activity (Dess et al., 2003) as it highlights the governance mechanisms firms can deploy to nurture the entrepreneurial faculty of their managers (Kor & Mahoney, 2004; Penrose, 1959) and encourage corporate entrepreneurship (Ireland, Covin, & Kuratko, 2009).

2. International corporate entrepreneurship

Entrepreneurship is the process by which "opportunities to create future goods and services are discovered, evaluated, and exploited" (Shane & Venkataraman, 2000, p. 218) and, as such, is associated with conducting new activities or actions (McMullen & Shepherd, 2006). For example, entrepreneurship has been viewed as creating new products or services (Hong, Song, & Yoo, 2013; Schumpeter, 1934). It also has been linked to entering new markets (Kuivalainen, Sundqvist, & Servais, 2007; Lisboa, Skarmeas, & Lages, 2011). In this vein, corporate entrepreneurship has been defined as "the process whereby an individual or group of individuals, in association with an existing organization, create a new organization or instigate renewal or innovation within that organization" (Sharma & Chrisman, 1999, p. 18).

The benefits of corporate entrepreneurial activity have been acknowledged extensively. However, more entrepreneurial activity is inevitably associated with greater uncertainty and risk (Lumpkin & Dess, 1996). International entrepreneurial activity, which includes entering new product lines as well as new geographic markets, involves particularly high level of uncertainty (Liesch, Welch, & Buckley, 2011; McMullen & Shepherd, 2006). MNEs that enter new geographic markets face extra market uncertainty, due to the complexity and diversity of the additional international environmental factors (Duncan, 1972). The variability of different national environments creates another layer of challenges (Johanson & Vahlne, 1977; Zaheer, 1995), since unpredictable changes are more likely to occur in new geographic markets. Offering new products adds another level of uncertainty and risk, since it may require foundational changes to current operations (Hoskisson, Hitt, & Hill, 1991; Zahra, 1991).

Prior research has considered the factors that drive an organization to engage in entrepreneurial activity. Entrepreneurial orientation and strategic orientation have been linked to entrepreneurial activity at firm level (Lumpkin & Dess, 1996; Miles & Snow, 1978). While high entrepreneurial orientation stimulates firms to innovate, this propensity is often associated with more risk-taking (Miller & Friesen, 1982). Similarly, different strategic orientations are associated with various levels of propensity for risk-taking and resource commitment and thus willingness to undertake entrepreneurial activities (Miles & Snow, 1978). For example, Liang, Musteen, and Datta (2009) found that *prospectors* tend to be more entrepreneurial and thus more likely to use an equity-based foreign entry mode, based on Miles and Snow's (1978) typology of the strategic orientations.

On the other hand, entrepreneurship research cannot ignore the "people side" (Mitchell et al., 2002) – the individual entrepreneurs who discover, evaluate, and exploit productive opportunities. In the context of corporate entrepreneurship, these individuals are the firm's managers. Significantly, Penrose (1959) distinguished managers' "entrepreneurial services" from their "managerial services". She viewed entrepreneurial services as strategic decision-making on behalf of a firm's owners, such as introducing new ideas and plans for expansion; these tasks often fall to the CEO (Ross, 2014). Entrepreneurial managers are expected to play a key proactive role in perceiving and pursuing productive opportunities (Kor & Mahoney, 2004).

Unfortunately, these entrepreneurial faculties are not equally available to all firms (Penrose, 1959). Firms need to develop the corporate culture and reward systems that nurture the entrepreneurial faculties of their managers (Kor & Mahoney, 2004; Ireland

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