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International expansion of U.S. full-service restaurants: Positive and increasing effects on financial performance

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ABSTRACT

Contrary to conventional wisdom, the current study found that full-service restaurant companies increasingly perform better as their degree of international expansion increases once their international stores reach 8.3% of their total store units, while the impact is significantly lower for quick-service restaurant companies for U.S. based companies. This study argues that various degrees of tacit knowledge required by operating full-service restaurant companies and quick-service restaurant companies explain the major reason for significant differences in success of international operations. As a firm's accumulated tacit knowledge for international operations becomes a source of sustainable competitive advantage, U.S. full-service restaurant companies increasingly perform better than U.S. quick-service restaurant companies; this disparity in performance is due to the relatively easy-to-transfer knowledge and standardized approaches of the U.S. quick-service restaurant companies.

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1. Introduction

Many U.S. companies, including U.S. restaurant firms, have sought new locations and growth opportunities throughout the world as they face intensive competition in the saturated U.S. market. According to the *Technomic Report* of 1998, in 1997 the largest 100 U.S. restaurant chains had a growth rate of 12.7 percent for international units while their growth rate for domestic units was a mere 2.8 percent (Hua and Upneja, 2011). A later edition of the *Technomic Report* of 2010 noted that during the economic downturn of 2009, the top 500 U.S. restaurant chains increased their international units by 5.2 percent while domestic units rose by 0.3 percent (Oak and Upneja, 2010).

This trend of internationalization in U.S. restaurants motivated hospitality researchers to study the effects of internationalization on restaurant firms' performances. Findings are mixed; Singh et al. (2003) compared the relative growth rates in multinational and domestic publicly listed U.S. based restaurant firms over a period of 20-year (1981–2000) and found that multinational firms exceed domestic firms in operating income and pre-tax profitability while no significant difference found in sales growth between the two. More recently, Hua and Upneja (2011) found a positive relationship between the degree of internationalization and the market capitalization of U.S. restaurant companies.

Mixed findings on the impact of internationalization on firms' performances in the restaurant industry call for further investigation, and the current research aims to investigate the moderating role of restaurant type on the relationship between internationalization and firms' performances. Rates of internationalization have not increased to the same degree within the restaurant industry: quick-service restaurant chains have been aggressively expanding overseas (Basham and Menza, 2007), while full-service restaurants have lagged in business expansion in the international market (Lee, 2008a). For example, Yum! Brands generated more than 50 percent of its revenue from overseas markets since 2007 (Kolb, 2011) and McDonald's reaped more than 50 percent of its revenue from international markets since 1994 (McDonald's, 2011). Equivalent levels of internationalization are rare among full-service restaurant companies.

Active international expansion among quick-service restaurant companies, however, does not necessarily result in better performances. Rather, the *incremental impact* of international expansion on firms' performances can be greater for full-service restaurant companies. The resource-based view asserts that a firm with skills and resources that are valuable, rare, hard-to-imitate, and hard-to-substitute will accumulate sustainable competitive advantages (SCA), and the firm with SCA will perform better over the long-term (Barney, 1991). Since full-service restaurant companies

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generally require more complex and sophisticated resources to serve patrons, their opportunities for establishing SCA when transferring skills and resources to overseas increase. This also translates into less need for price competition and higher profit margin than quick-service restaurants. Arguably, incremental benefits accruing to full-service restaurant companies from international expansion significantly outweigh costs as experiences in international operation accumulate. Even though transmission of such resources is likely to be more difficult and associated costs are significant at first, once transferred, the advantage becomes sustainable.

An example of full-service restaurant companies' requiring complex and sophisticated resources appears in the 1993 annual report of Luby's Cafeterias, which states the need for seven years to fully train one general manager, transferring specific knowledge required for operation (Hoover et al., 2003). Such a time requirement for knowledge transfer is expected significantly lower for quick-service restaurant companies since, by nature, they design their standardized resources to be more easily transferable. Grant (1996) pointed out that it is more efficient for McDonald's to create standardized operating rules than to educate every manager in every aspect of the management in order to replicate its products and services easily and to optimize restaurant operation. All levels of restaurants can create and apply standards for their operations, but restaurants that have higher complexity in activity require a significantly higher amount of effort to do so.

In sum, this study empirically investigates the differing impact of internationalization on firm performance between full-service restaurant companies and quick-service restaurant companies. Specifically, the contention is that the incremental impact of international expansion on firms' performances is greater for full-service restaurant companies than quick-service restaurant companies once beyond a certain point. The difference is due to greater opportunities for establishing SCA that stem from more complex and sophisticated resources to serve patrons. The current study enriches the international business literature and hospitality literature, which has revealed mixed findings, by considering the role of restaurant type as applicable to the relationship between internationalization and firms' performances in the context of the restaurant industry. This study also provides insights for practitioners in the restaurant industry by challenging the conventional notion that quick-service restaurant companies provide better opportunities for financial performance from internationalization than full-service restaurant companies do.

2. Literature review

2.1. Theoretical background: benefits and costs of internationalization

Several theories explain the benefits of internationalization. From an economic perspective, Buhner (1987) highlighted prospective market opportunities and firms' greater growth from internationalization opportunities. Firms enjoy other advantages, such as economies of scope and scale from cost savings by sharing cost-producing activities among geographic markets (Kogut, 1985; Ghoshal, 1987). In addition, the imperfect capital market theory argues that international firms can enhance value in an imperfectly efficient global capital market where various constraints exist, such as information asymmetries and regulations. Investors view investing in internationally diversified firms a means of reducing those constraints; therefore, they prefer international firms to domestic firms (Doukas and Travlos, 1988).

From a behavioral perspective, researchers emphasized benefits from the interaction between establishments within an international firm. For example, building upon the resource-based view (Barney, 1991), Tallman and Li (1996) argued that international firms may transfer their core competences to foreign markets to capitalize on internal capabilities; this can result in firms' greater performances. Birkinshaw (1997) found that international firms may develop, test, and promote new products in foreign subsidiaries, thereby providing opportunities to further invest in distinctive local knowledge and capabilities. Using a sample of 110 American multinational enterprises (MNEs), for example, Hsu and Pereira (2008) found that international expansion allows MNEs to appropriate certain resources within their units and to exploit competitive advantages learned from their expansion experience, thereby positively affecting return on sales, return on investment, and return on equity. Barkema and Vermeulen (1998) argued that processes for establishing and managing subsidiaries in foreign countries may lead to temporary problems, but various advantages remain for international firms' core businesses, global brands, research and development (R&D), information technology (IT) expenditures, procurement, financial resources, and merger frenzy (Nolan et al., 2002).

Prior research, however, also acknowledged the various costs of internationalization. International diversification is complex and difficult to manage (Roth, 1992; Roth and Morrison, 1991) since international companies confront management of cultural diversity and unique customers' needs (Gomez and Ramaswany, 1999). As the level of internationalization increases, the transaction, managerial, and coordination costs of far-flung operations may increase complications for controlling businesses (Gomez and Ramaswany, 1999). Tong and Reuer (2007) documented that the complexity of the multinational network and the coordination challenges derived from cultural differences may negatively influence firms' performances, thereby increasing risk levels. In addition, Sanna-Randaccio and Veugelers (2007) pointed out the risks of knowledge leakage, the possibility of know-how spillovers to competitors as degree of internationalization rises.

From the resource-based perspective, Cuervo-Cazurra et al. (2007) identified three characteristics of difficulties involving internationalization: (1) the loss of advantage, which occurs when resources cease to provide an advantage in a new country; (2) the creation of disadvantage, which occurs when resources become liabilities while transferring the resources; and (3) the lack of complementary resources, which occurs when foreign operations demand additional resources not necessary in the domestic market.

2.2. Relationship between internationalization and firms' performances

Based on the concepts of benefits and costs of internationalization, scholars inquired into whether—and the methods by which—internationalization influences firms' performances during the past four decades. Findings have been inconclusive and fragmented with regard to countries of origin and/or industries. Vernon (1971), in one of the earliest empirical studies to examine the relationship between the degree of internationalization and firms' performances, found evidence in support of a positive linear relationship from data representing 187 large U.S. manufacturing firms. Buhner (1987), in a study of the 40 largest West German firms, found that relatively small but highly industrialized companies create positive value for shareholders when companies expand internationally. However, several studies found either no significant relationship (e.g., Dunning, 1985; Kumar, 1984; Rugman et al., 1985) or even a negative relationship between international expansion and stocks' returns (e.g., Brewer, 1981).

The mixed results led researchers to consider the possibility of a non-linear relationship between internationalization and firms' performances (i.e., a U-shaped or an inverted U-shaped

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