Journal of International Management 20 (2014) 345–358

Contents lists available at ScienceDirect

Journal of International Management

Fox School of Business
TEMPLE UNIVERSITY®

The Impact of Vicarious Experience on Foreign Location Strategy

Guoliang F. Jiang [a,*], Guy L.F. Holburn [b,1], Paul W. Beamish [b,2]

[a] Dalhousie University, Rowe School of Business, 6100 University Avenue, Halifax, Nova Scotia B3H 4R2, Canada
[b] Western University, Ivey Business School, 1255 Western Road, London, Ontario N6G 0N1, Canada

ARTICLE INFO

Article history:
Received 18 April 2013
Received in revised form 21 October 2013
Accepted 22 October 2013
Available online 16 November 2013

Keywords:
FDI
Location choice
Vicarious experience

ABSTRACT

MNEs can learn from the foreign investment experiences of other firms when evaluating their own foreign entry strategies. We argue that other firms' experiences reduce investment barriers arising from formal and informal institutional environments in host countries that are dissimilar from an MNE's home country, thereby encouraging new entry. Our empirical analysis of foreign entries by Japanese public manufacturing firms over more than a thirty-year period indicates that the prior experiences of other firms in a host country mitigate the negative effect of formal and informal institutional distance on entry decisions: as other firms' experiences in a host country increase, a firm is less deterred by greater institutional distance from entering the country. We also find that the distance-mitigating effect of other firms' experiences in different industries is less significant when a larger body of same-industry firm experience exists in a country, implying a substitution effect between different types of vicarious experience.

1. Introduction

Research on MNEs' foreign expansion strategy has substantially drawn on organizational learning theory (Cyert and March, 1963; Huber, 1991; Levitt and March, 1988). One prominent application is the Uppsala process model of internationalization which posits that MNEs only enter host countries that are more dissimilar or 'distant' from their home country after first accumulating experience and market knowledge in more proximate countries (Davidson, 1980; Dow, 2000; Eriksson et al., 1997; Erramilli, 1991; Johanson and Vahlne, 1977). While the model remains influential, it is limited by its focus on the effect of a firm's own direct experience, consequently overlooking the potential influence of investment activities of other firms (Forsgren, 2002). Yet organization theory suggests that prior strategic choices of other firms provide information that a firm can use to inform the formulation of its own strategy (Argote et al., 1990; Lieberman and Asaba, 2006; Miner and Haunschild, 1995). Following research that refers to information emerging from others' activities as 'vicarious information', we refer to the foreign investment experience of other firms as 'vicarious experience' (Bandura, 1977; Kalnins et al., 2006; Kim and Miner, 2007).

While studies have shown that vicarious experience in a host country tends to positively influence subsequent investment flows (Bastos and Greve, 2003; Guillen, 2002; Henisz and Delios, 2001), few have delineated or tested the mechanisms that lead to this effect. In this study we contend that vicarious experience reveals information about the formal and informal institutional environments of a country, which enhances a focal firm's ability to manage subsidiary operations in institutionally distant locales — thereby mitigating the negative effects of host country 'distance' and encouraging entry (Globerman and Shapiro, 2003; Grosse and Trevino, 1996; Holburn and Zelner, 2010). We argue that vicarious experience is especially valuable when evaluating investment opportunities in more unfamiliar or distant countries as foreign firms confront greater difficulties in accurately assessing opportunities and risk in these

* Corresponding author. Tel.: +1 902 494 8999; fax: +1 902 494 1107.
E-mail addresses: frank.jiang@dal.ca (G.F. Jiang), gholburn@ivey.uwo.ca (G.L.F. Holburn), pbeamish@ivey.uwo.ca (P.W. Beamish).
[1] Tel.: +1 519 661 4247; fax: +1 519 661 3485.
[2] Tel.: +1 519 661 3237; fax: +1 519 661 3485.

1075-4253/$ – see front matter
http://dx.doi.org/10.1016/j.intman.2013.10.005

environments. Building on the premise of an overall positive influence of vicarious experience, our analysis presents a closer investigation of the channels of influence among organizations and provides new insights into the underlying mechanisms.

Vicarious experience differs from direct experience in that it originates from firms with different attributes. Research has begun to explore how different types of vicarious experience – that of same-industry firms and that of different-industry firms – have affected firm strategy, though studies have treated each type independently (Bastos and Greve, 2003; Guillen, 2002; Henisz and Delios, 2001; Henisz and Macher, 2004). Here we contribute to this research stream by also studying the interaction between same-industry and different-industry vicarious experience and their relative impact, asking whether these two types are partially substitutable.

We test our predictions using a dataset of foreign manufacturing investments made by publicly listed Japanese manufacturing MNEs between 1971 and 2003. We find that the negative impact of formal and informal institutional distance between a host country and a home country on investment location choice is attenuated by the experience of other home country firms in that host country. We also find that when there is a higher level of same-industry experience in a host country, the mitigating effect of different-industry experience on the negative influence of formal and informal institutional distance becomes weaker. This substitution effect between same-industry and different-industry vicarious experiences implies that vicarious experiences originating in different groups of firms have differential values from a learning perspective. Our findings suggest that observed patterns of geographic concentration of firms' investments are driven in part by the effect of enhanced information availability that vicarious experience confers.

2. Theoretical background

2.1. Direct and vicarious experience

Organizational learning changes a firm's knowledge repertoire of routines that guides its behavior (Nelson and Winter, 1982). As a firm repeatedly engages in an activity, its ability to efficiently manage the activity improves because the firm is able to infer insights from previous outcomes and adjust its actions accordingly (Levitt and March, 1988). Learning based on direct experience is often an important source of competitive advantage and superior performance for MNEs (Barkema et al., 1996; Chang, 1995).

Firms also learn beyond their organizational boundaries by observing the behaviors of other firms (Huber, 1991; Levitt and March, 1988). The potential benefits of vicarious experience arise because private information is not always available or adequate to inform the individual firm's decision-making and inductive learning from direct experience can be poorly construed owing to complex causal linkages within organizations (Barney, 1991). Actions of other firms reveal information regarding the environment and the knowledge base of those firms (Argote et al., 1990; Darr et al., 1995). Firms may thus acquire practices from other firms or refine their own routines based on the perceived outcomes of other firms' actions (Haunschild and Miner, 1997; Ingram and Baum, 1997). For MNEs, vicarious experience derived from other firms' investment activities provides one mechanism for developing competitive advantage that can be leveraged abroad (Alcacer and Chung, 2007; Li and Yao, 2010; Shaver et al., 1997).

Recent studies of productivity improvement, investment strategy, and talent development suggest that the influences of direct and vicarious experience are not independent or simply additive processes (Darr and Kurtzberg, 2000; Schwab, 2007; Yang and Hyland, 2012). The effect of vicarious experience differs among firms because of heterogeneity in learning predisposition, which is partly a function of differences in the amount and composition of direct experience. Argote et al. (1990) found that once new shipyards began production, they benefited little from the experience of other shipyards. Single-host country studies have shown that when firms already possess general knowledge about target industries or locations they are less likely to learn from their competitors (Guillen, 2002). A similar diminishing effect of a firm's own experience is also evident in cross-country analysis of foreign investment strategies (Henisz and Macher, 2004).

Although studies have shown that vicarious experiences originating in heterogeneous groups tend to have similar and positive influences on a focal firm's investment choices (Bastos and Greve, 2003), few have systematically examined the trade-offs between, or relative values of, different types of vicarious experience. Yet, information processing needs and the relevance of acquired knowledge can vary depending on the origin of vicarious experience because the differences in resource and strategic profiles between firms of different industries influence the nature of vicarious experience (Galbraith, 1974; Nelson and Winter, 1982). Hence, the experience of firms in the same industry as a focal firm is likely to have different influence on entry decisions than the experience of firms in different industries.

2.2. Entry experience and investment location strategy

Direct experience derived from foreign operations enables MNEs to reduce investment risks arising from dissimilarities between host and home country business environments (Johanson and Vahlne, 1977). The dissimilarities, or 'distance,' create a 'liability of foreignness' for MNEs that can deter foreign investment (Denk et al., 2012; Gaur and Lu, 2007; Ghemawat, 2001; Zaheer, 1995). The challenge MNEs face is multi-faceted. First, differences in formal and informal institutions directly translate into information costs and coordination costs (Globerman and Shapiro, 2003; Hutzschenreuter et al., 2011). A firm must acquire and process new information in order to understand a foreign market where consumer preferences, regulations, and business norms may differ significantly from those in its home environment, raising the costs of entry. Second, institutional differences may lead to greater contractual hazards and business risks (Kogut and Singh, 1988). Finally, the idiosyncrasies or specific demands of distant markets may render capabilities that were developed in a firm's home country obsolete or less valuable,