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# When over internationalized companies reduce their international footprint

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ABSTRACT

This paper questions if the most advanced companies in terms of internationalization tend to reduce their international exposure overtime. On a sample of highly internationalized multinationals observed over a 12 year-period (1997–2008), we discuss and explore the effects of internationalization on performance and we find an inverted U-shaped relationship between internationalization, confirming the existence of an optimal degree of internationalization. The major finding of this research is that beyond this optimum, the most advanced companies in terms of internationalization tend to reduce their international footprint over time, unlike the other companies.

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## 1. Introduction

Many empirical studies over the last 30 years have examined the relationship between the degree of internationalization (I) and performance (P), to test whether internationalization of companies increases their performance. The results of nearly a hundred empirical or theoretical studies in strategy or international business have led to no consensus on this relationship between (I) and (P) (see in particular Ruigrok and Wagner (2003) and their review of 62 studies or Li (2007) and his analysis of 43 studies). However, recent studies seem to converge around a cubic relationship between (I) and (P) and have led to the '3-stage paradigm' of internationalization (Contractor, Kundu, & Hsu, 2003; Thomas & Eden, 2004; Lu & Beamish, 2004; Li, 2005; Contractor, 2012)[1]. These studies have identified an S-curve relationship suggesting that companies would experience three stages during their internationalization process and attesting that internationalization is not necessarily a guarantee of success in terms of financial performance. Those recent studies question to what extent should transnational companies continue to expand if this strategy was not always profitable.

Two examples can be highlighted to illustrate this adaptation of strategy decisions to the inverted U relationship between (I) and (P): Carrefour (a services company) and In Bev (a manufacturing company) have both being characterized by a large geographic refocusing movement.

Because of its internationalization's strategy, Carrefour is now the second largest retailer in the world after Wall-Mart. Carrefour has selected the countries for internationalization's strategy on the basis of selected criteria mainly market size, geographical proximity and compatibility of operations. That explains the choice of Belgium, Spain and Italy as ones of the first markets to entry and the importance of these countries even today. Carrefour decided also to go in many other countries, and to develop regional poles in South America (Brazil, Argentina) and in South East Asia (Taiwan, Malaysia, Thailand and Indonesia) and China, as these countries are the most important growth market in the World. Between 1990 and 2006, Carrefour entered 29 new countries. However, these markets are characterized by high differences with Europe: regulations in the retail markets vary on the basis of religion, culture and taste. To recover its profitability, Carrefour decided to change its internationalization strategy and to separate from its non-strategic or insufficiently profitable assets. After leaving Hong-Kong in 2000, Chile, Mexico, Japan, South Korea, Czech Republic and Slovakia were sold. The objective was to keep only the subsidiaries which belong to the first three distributors of the market concerned and Carrefour is now quite cautious in its international operations.

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[1] See Appendix A.

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AB Inbev is today the number one brewing company in the world that was born as a result of a series of mergers and acquisitions dating back to the 1980's. Among the main mergers, InBev (Belgium company) first merged in 2004 with AmBev (Brazilian brewer), then merged with Anheuser-Busch in 2008 to create AB Inbev. Throughout all the years the company has expanded all over the world having operations in over 30 countries and sales in over 130 countries in the industry of beer. Internationalization was rapidly considered as the determinant of the competitive strategy and the company's success. AB Inbev decided to become a global company expanding mostly in new developing countries from Central and Eastern Europe (Hungary, Croatia, Bulgaria, Romania) in the late 1980s then in Asia and South America in the period 1995–2007. After the takeover of Anheuser-Busch for an amount of $52 billion dollars, In Bev decided to refocus on a limited number of countries to reduce its debt. Between 2007 and 2009, Ab-InBev has refocused in selling breweries in nine countries of Central and Eastern Europe to CVC Capital Partners for more than $8 billion, two regions where the company has started its internationalization in the mid 1990's.

If those two examples and recent theoretical works have questioned the existence of an optimum in terms of geographic expansion, very few works have tried to analyze whether companies take this optimum into account when making strategic decisions. The main contribution of this study is first to test the fit between (I) and (P) and then to analyze over a long period if large transnational companies adjust their degree of multinationality according to its impact on firm performance.

This empirical study on the relationship between (I) and (P) is also original in several respects. It is original first because of the nature of the data: we focus on companies already very advanced in terms of international diversification. Our sample is composed of transnational companies with the highest volumes of foreign assets[2] because we want to understand what happens for companies that may be over-internationalized. Our study is also original because, contrary to most empirical studies, we do not refer to a single variable measuring only one aspect of internationalization[3]. In line with certain studies that have proposed a multi-item index to measure internationalization (Thomas & Eden, 2004; Annavarjula & Beldona, 2000; Li & Qian, 2005; Contractor et al., 2003; Goerzen & Beamish, 2003), this study refers to a composite measurement of internationalization namely the Transnationality Index (TNI). Lastly, this study integrates companies of different nationalities whereas almost all previous studies have focused on a single country[4].

Based on a sample of 521 observations of large multinationals, our study, after validating the existence of an optimum degree of internationalization, shows that among the largest multinationals, companies with the highest degree of internationalization tend, unlike the others, to decrease their level of internationalization over the period (1997–2008).

[2] The sample is composed of the annual ranking of the 100 most internationalized companies identified in the World Investment Report (WIR). The WIR presents a ranking of multinational companies by the amount of foreign assets owned.

[3] Internationalization is often measured by the ratio Foreign Sales/Total Sales (FS/TS) (Geringer, Tallman, & Olsen, 2000; Capar & Kotabe, 2003; Ruigrok & Wagner, 2003; Li, 2007), an indicator of foreign market penetration that has recently been criticized (Hennart, 2011). Internationalization is also often measured by the number of subsidiaries and the number of host countries (Lu & Beamish, 2001, 2004; Zahra, Ireland, & Hitt, 2000).

[4] Only U.S. firms for Kotabe, Srinivasan, and Aulakh (2002), Thomas and Eden (2004), Li and Qian (2005), Contractor et al. (2003) and Li (2005); only Japanese firms for Geringer et al. (2000) or Lu and Beamish (2001, 2004); only German firms for Capar and Kotabe (2003) or Ruigrok and Wagner (2003).

## 2. Theoretical bases and hypotheses

The idea that internationalization systematically increases companies' profitability was attacked and has led to the conclusion that there is a limit to international growth (Verbeke & Brugman, 2009; Hennart, 2011; Contractor, 2012). In particular, Lu and Beamish (2004) and Contractor (2007, 2012) have developed theoretical models listing the benefits and costs across different stages of internationalization. During early internationalization (Stage 1, called "initial stage), companies generally experience a drop in their performance. Stage 1 is characterized by high costs of learning about a new environment (unfamiliarity of new countries): set-up costs of international operations are high per product sold abroad and are likely to be greater than the benefits. In Stage 2, benefits begin to outweigh costs, as the learning cost about how to establish an affiliate efficiently in a host country is reduced. Stage 2, called 'later internationalization' or "middle stage" is associated with increasing profitability related to internationalization, as companies develop experiential learning and because geographical diversification reduces the overall risks. During Stage 3, called 'excessive internationalization', the effects of internationalization on performance become negative: companies have 'over-internationalized' their activities. Stage 3 is generally characterized by a large number of affiliates that increases the volume of management information and coordination costs. However, most of the studies and in particular recent studies like those of Contractor (2007, 2012) or Hennart (2007, 2011) cannot validate the universality of any list of benefits and costs for all companies. For a company, profits and costs are not necessarily generated at the same time or at the same stage of its international development.

Empirical studies have evidenced an optimum point in terms of internationalization that result in an inverted U-shaped curve. "The negative slope on the right hand side of the inverted U-Shaped curve unequivocally means that further multinational expansion (...) is detrimental to profit and performance" (: 36). However, for Contractor (2007), the results of all empirical studies on the question can be reconciled by a '3-stage theory of international expansion', as U-shaped and inverted U-shaped relationships could be subsets of the general '3-stage' sigmoid curve.

But what are the main theoretical arguments to justify this optimum level of international diversification? Do managers of large companies know that they have reached this optimum? And do they adapt their strategic decisions when they have reached the optimum in terms of international expansion?

### 2.1. More is it systematically better? The cost of over-internationalization

A recent group of studies emphasize this idea that multinational companies may reach an optimal degree of international diversification beyond which any increase in the international footprint is detrimental to performance (Hennart, 2007, 2011; Contractor, 2012). At a company level, there should be a maximum number of countries that should be served. Internationalization incurs costs for the expanding companies which explains why over internationalization can have a negative influence on profitability and why over internationalized companies may reduce their degree of internationalization.

There are many reasons why internationalization can generate costs superior to benefits:

- *Cultural and institutional distance*. The benefits and costs of internationalization will not accrue homogeneously across all

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