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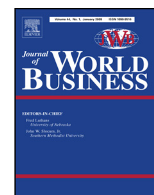

The interactive effect of time and host country location on Chinese MNCs' performance: An empirical investigation

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ABSTRACT

We explore the performance implications of location choices Chinese multinational corporations (MNCs) make. Drawing on internalization and organizational learning theories, we find that developing country MNCs entering other developing countries experience a positive effect on their performance in the immediate term that, however, erodes over time because of the decay in their initial internalized advantages. Conversely, MNCs entering developed countries experience a negative effect on their immediate-term performance but a boost in performance over time because of the gradual realization of learning benefits. Our analyses of internationalization and performance of 207 Chinese-listed MNCs between 1992 and 2005 corroborate our key predictions.

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1. Introduction

How does international expansion affect the performance of developing country multinational corporations (MNCs)? Do the performance implications vary depending on the location of the investment and the time frame in which performance is examined? These questions are the focus of our study, in which we aim to advance the literature on developing country MNCs.

Prior studies have highlighted the trend of rising foreign direct investment (FDI) from developing countries (Chari, 2012; Duanmu, 2012; UNCTAD, 2006). For example, according to the data of China Stock Market & Accounting Research database, Chinese-listed firms had approximately 20 foreign subsidiaries in 1992, but this number increased to more than 600 in 2005. Growing ambitions of developing country MNCs are not limited to setting up a larger number of subsidiaries. Despite weak performance in the initial stage of their operations in developed countries, many developing country MNCs have established subsidiaries in developed countries, thus adding to the diversity and complexity of their strategies (Ernst, 1998; Guidice & Cullen, 2007; Ramamurti, 2004; Wesson, 1994). According to the American Certification Institute (2008), two of every three Chinese firms in the United States incurred losses in the first year of their operation. In contrast, many Chinese MNCs exhibited good performance in other developing countries, such as Indonesia, the Philippines, and Malaysia, immediately after entry (Child & Rodrigues, 2005). This anomaly between developing country MNCs' ambitions and their initial poor performance in developed markets is worthy of research attention. While investigating this important issue, we also address some of the equivocal findings in the literature on the relationship between internationalization and performance.

Many prior studies on this topic have taken a snapshot approach to examine how internationalization affects MNCs' performance and have produced inconsistent findings, such as an S-shaped relationship, a U-shaped relationship, and an inverted U-shaped relationship (e.g., Contractor, Kundu, & Hsu, 2003; Geringer, Beamish, & daCosta, 1989; Lu & Beamish, 2004; Ruigrok & Wagner, 2003). To reconcile the mixed findings, we propose that the internationalization–performance relationship should be examined well beyond the immediate term, especially because the benefits and costs of internationalization may change over time, as may, accordingly, the initial performance. For example, for an ambitious developing country MNC, the initial competitive disadvantages associated with expansion into developed countries, such as the lack of innovative products or brand reputation, could be fleeting. The Chinese telecom equipment manufacturer Huawei is an instructive case in this regard. Despite beginning as a small player with technological disadvantages, it has become a contender in its industry by following an aggressive technology

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development and international expansion agenda. With regard to changes in developing country MNCs' initial performance, the initial advantages related to internalization of assets in other developing countries may also erode over time because of competitive imitation or an evolving environment. Therefore, it is important for research on the internationalization–performance relationship to adopt a more dynamic approach.

We do so by integrating the arguments of internalization and organizational learning theories and explicitly examining the effects of internationalization on performance in the immediate term as well as performance changes over time. We also introduce contingencies for the internationalization–performance relationship in the form of host country characteristics (developed vs. developing countries). Our data, which include 14 years' worth of internationalization moves (1992–2005) by Chinese-listed firms and their performance, are particularly valuable for examining performance over time. Such a combination of contingent and longitudinal approaches should provide a more complete understanding of the internationalization–performance relationship and also enable us to shed light on the apparent anomaly of developing country MNCs' increasing investment in developed countries despite their initial poor performance. Finally, to address the dynamic aspects of benefits, costs, and performance due to internationalization, we employ a rigorous methodology, including the two-stage least squares (2SLS) estimation procedure, which tackles endogeneity issues, thus giving confidence in our results.

2. Theoretical development

2.1. Internalization theory

Internalization theory is an important perspective in international business literature and has long provided an explanation for the motivation and existence of MNCs (Buckley & Strange, 2011). In essence, this theory states that FDI occurs when a firm internalizes markets for one or more intangible assets including technological know-how, marketing expertise (including consumer goodwill in the form of brand name reputation), and management expertise (Buckley & Casson, 1976; Kirca et al., 2011; Morck & Yeung, 1991). These assets are difficult to trade through arm's-length transactions because of factors identified by the economics of information literature (e.g., they have some characteristics of public goods as well as elements of proprietary information) as well as other factors (e.g., difficulty in separating the asset from the firm and sharing with a third party). By exploiting the benefits of internalization, firms could gain advantages such as economies of scale and scope and a greater return on their core competencies (Capar & Kotabe, 2003; Ghoshal, 1987; Hamel, 1991; Kogut, 1985). In addition, MNCs may be able to generate performance improvements over non-MNCs, by allocating their resources more efficiently and effectively across markets (Kobrin, 1991), and to gain an additional performance boost through an oligopolistic market structure (when present) in host countries (Capar & Kotabe, 2003; Sundaram & Black, 1992). All these arguments suggest that, all else being equal, the performance of firms should be positively correlated with the internationalization level (Delios & Beamish, 1999; Errunza & Senbet, 1984; Kirca et al., 2011).

However, recent studies have criticized the extant approach of testing the internationalization–performance relationship. Hennart (2007) and Verbeke, Li, and Goerzen (2009) argue that there is no theoretical rationale for expecting a generalizable relationship between internationalization and performance. This dichotomy of perspectives, one predicting a relationship and the other challenging the prediction, presents an opportunity to further develop and refine understanding of the contingencies under which greater internationalization will lead to better performance.

According to prior studies, internationalization enhances performance under two sets of conditions: when MNCs (1) choose foreign countries in which they can effectively exploit their valuable skills and assets (e.g., where they can derive a competitive advantage over their rivals) and (2) internalize assets up to the point at which the benefits of internalization exceed the costs (Buckley, 1988; Kirca et al., 2011). The first condition suggests that location has a strong effect on an MNC's ability to realize the benefits from internationalization (Buckley & Casson, 1976). In addition, recent work suggests that competitive advantage is difficult to sustain in today's highly uncertain and volatile environment (Chen, Katila, McDonald, & Eisenhardt, 2010a; Chen, Lin, & Michel, 2010b; D'Aveni, Dagnino, & Smith, 2010; Sirmon, Hitt, Arregle, & Campbell, 2010; Wiggins & Ruefli, 2002). For example, the advantages derived from internalization of firm-specific assets in foreign markets may erode over time because of imitation by rivals, adversely affecting performance. Therefore, time is the second contingent factor influencing the positive effect of internationalization on firm performance.

2.2. Organizational learning theory

Organizational learning is the process of creating, retaining, and transferring knowledge within an organization. It allows an organization to stay competitive in an ever-changing environment through improvements that can increase efficiency, efficacy, or profits (Cyert & March, 1963). Organizational learning enables a firm to develop new knowledge and capabilities, which in turn help the firm create and maintain competitive advantage (Fiol & Lyles, 1985; Nelson & Winter, 1982; Uotila, Maula, Keil, & Zahra, 2009). From the organizational learning perspective, firms that internationalize have greater opportunities to enhance existing capabilities or develop new capabilities because of exposure to diverse contexts such as host country regulations, competitors, and customers with different needs and preferences than home market customers (Ghoshal, 1987; Kostova & Roth, 2002; Zahra, Ireland, & Hitt, 2000). Prior research suggests that developing country MNCs with a strong learning capability may even be able to leverage the learning from environmental diversity to overcome their competitive disadvantages (e.g., versus other MNCs) and possibly develop new competitive advantages (e.g., over local firms in foreign markets) (Hennart, 2007; Yiu, Lau, & Bruton, 2007). This argument has often been suggested as a motivation for developing country MNCs' expansion into sophisticated and challenging developed countries (Child & Rodrigues, 2005; Luo & Tung, 2007).

The effectiveness of learning in the internationalization process, however, also depends on contextual factors. According to Schulz (2001), organizational learning involves sourcing new knowledge from the environment and therefore is influenced by the characteristics of a firm's existing knowledge stock (Argote & Ingram, 2000; Simonin, 1999). In addition, because learning is the process of improving a firm's routines, which involves steps such as searching for and obtaining information from different sources, distributing and sharing information internally to create one or more commonly understood interpretations (knowledge), and storing the knowledge for future use (Huber, 1991), the benefits from organizational learning may not accrue immediately (Fiol & Lyles, 1985; Martin & Salomon, 2003; Zhang, Li, & Li, 2014). More important, the time lag for learning benefits to manifest may be a function of the environment, with longer lead times in some environments (Huber, 1991). For example, building a brand or creating innovative products, which may be essential for

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