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Dynamic capabilities as a mediator linking international diversification and innovation performance of firms in an emerging economy

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A B S T R A C T

International diversification has become a vital innovation strategy for firms in emerging economies. This study investigates an under-researched topic: the relationships between international diversification, capabilities and innovation performance among firms in an emerging economy. We offer a dynamic capabilities explanation for the relationship between international diversification and firms' innovation performance. By employing a large sample of Chinese manufacturing firms, our investigation demonstrates that while international diversification is important in the innovation effort, its effect on innovation performance is mediated through each firm's opportunity-recognizing capability and opportunity-capitalizing capability. The implications of these findings for theoretical development and future research are discussed.

1. Introduction

International diversification, defined as expansion across the borders of global regions and countries into different geographic locations or markets (Hitt, Hoskisson, & Kim, 1997), is an important innovation strategy for emerging market multinational corporations (EM MNEs) to catch up with MNEs in developed countries in rapidly changing environments (Li, Wu, & Zhang, 2012; Luo & Tung, 2007;). After entering into foreign countries, EM MNEs can obtain resources and learning opportunities for innovation capability-building (Li et al., 2012). In theory, research on the international diversification of EM MNEs has also become a renewed hot topic in this decades (see the articles in the special issues edited by Cuervo-Cazurra (2012)). Extant literature has mainly focused on the motives (Child & Rodrigues, 2005; Luo & Tung, 2007), processes (Luo & Tung, 2007), strategies (Luo & Tung, 2007; Peng, 2012) and antecedents of international diversification (Buckley et al., 2007; Gammeltoft, Pradhan, & Goldstein, 2010; Hobdari, Gregoric, & Sinani, 2011; Luo & Wang, 2012) of EM MNEs, and presumed the international diversification is beneficial for EM MNEs. However, the positive anticipation is largely through detailed theoretical derivation, and the empirical research that whether and how does international diversification affect EM MNEs' innovation is largely ignored.

While prior empirical studies on the innovative consequence of international diversification which largely have been carried out in developed countries, advance our understanding of the relationship between EM MNEs' international diversification and innovation, gap remains. It has been argued that, on the one hand, international diversification enables firms to access diverse innovative resources that are not available at their home market and triggers them to search for new ways of doing businesses, therefore facilitating their innovation (Hitt et al., 1997; Kafouros, Buckley, Sharp, & Wang, 2008; Li et al., 2012). On the other hand, international diversification provides firms with the opportunity to learn from foreign customers, suppliers, competitors and even alliance partners which increases the likelihood of internationalized firms to innovate (Hitt et al., 1997; Zahra, Ireland, & Hitt, 2000; Salomon & Shaver, 2005; Li et al., 2012). However, existing research does not explain the transformation process of innovative resources and knowledge into innovation performance.

While possession of resources is important, the capability-building theory suggests that capabilities are a source of inimitable and sustainable competitive advantages to the firm, because they transform resources into products or services superior to those of competitors (Amit & Schoemaker, 1993; Grant, 1991; Makadok, 2001). Research indicates that activities such as acquiring, absorbing, coordinating, and integrating resources from external and partner organizations can generate capabilities (Teece, Pisano, & Shuen, 1997). Therefore, despite

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the documented relationship between international diversification and innovation performance, we need to further explore what distinctive capabilities EM MNEs have established to achieve superior innovation performance.

To address this research gap, we employ the dynamic capabilities perspective (Eisenhardt & Martin, 2000; Makadok, 2001; Teece, Pisano, & Shuen, 1997) to examine the firm-specific capabilities that uncover the intermediate process of international diversification on innovation performance. By employing a large-scale sample of Chinese manufacturing firms that have internationalized, we focus on two specific capabilities, including opportunity-recognizing capability and opportunity-capitalizing capability, and their relationships with international diversification and innovation performance. While the theoretical links of interest in this study are not necessarily confined to the Chinese context, China's unique institutional environment and the internationalization orientation of Chinese manufacturing firms provide an appropriate platform to test our hypotheses.

2. Theory and hypotheses

Resource-based view and organizational learning theory are the dominant views in the research on the relationship between international diversification and innovation performance (Hitt et al., 1997; Zahra et al.,2000; Kafouros et al., 2008; Salomon & Jin, 2010; Li et al., 2012).Resource-based view argues that international diversification provides firms with incentives and resources to invest in innovation(Hitt et al., 1997). Internationally diversified firms can utilize the wider range of resources available globally, and which are often unavailable to domestic firms (Kafouros et al., 2008). Except that, because firms operating in international markets face greater competitive pressure than in domestic markets, they tend to intensify their search for innovative resources and invest more to enhance their innovation capability (Li et al., 2012). Organizational learning theory argues that international diversification provides the opportunity for firms to learn from a variety of market and cultural perspectives (Hitt et al., 1997; Zahra et al., 2000; Salomon & Jin, 2010). This suggests that internationally diversified firms have greater opportunities to learn new and diverse ideas from foreign customers, suppliers, competitors and alliance partners (Zahra et al.,2000), which can increase their innovative capacity.

However, the capability-building view holds that only possession of resources is not enough, capabilities are a source of inimitable and sustainable competitive advantages to the firm, because they transform resources into products or services superior to those of competitors (Amit & Schoemaker, 1993; Grant, 1991; Makadok, 2001). Especially in situations of rapid and unpredictable change, where the competitive landscape is shifting, dynamic capabilities by which firm managers ‘integrate, build, and reconfigure internal and external competencies to address rapidly changing environments’ (Teece et al., 1997:516) become the source of sustained competitive advantage. In this paper, we argue that international diversification promotes the creation of dynamic capabilities which in turn promote the enhancement of EM MNEs' innovation performance (Fig. 1). Next we will briefly tell the difference between resources and capabilities, review the theory of dynamic capabilities, and then put forward our hypotheses.

2.1. The difference between resources and capabilities

The RBV literature presents divergent views about resources and capabilities (Priem & Butler, 2001). Some researchers tend to view the terms as synonymous (Newbert, 2008). This combining of the two concepts is based in part on Barney's (1991) definition of resources, which lists together firm assets, capabilities, processes, attributes, information, and knowledge. However, the dominant view (e.g., Amit & Schoe-maker, 1993; Grant, 1991; Makadok, 2001) is that resources and capabilities are clearly distinguishable from one another. Grant (1991) argues that resources are stocks of tangible or intangible assets, such as fixed assets, information, brand, technology, and human capital, which firms use as inputs into production processes for conversion into products or services. Makadok (2001) defines a capability as “a special type of resource -specifically an organizationally embedded non-transferable, firm-specific resource whose purpose is to improve the productivity of the other resources possessed by the firm” (Makadok, 2001: 389).

More specifically, Amit and Schoemaker (1993) argue that firm-specific capabilities “can abstractly be thought of as ‘intermediate goods’ generated by the firm to provide enhanced productivity of its resources” (Amit & Schoemaker, 1993: 35). Thus capabilities are different from resources as they enable firms to create economic rent more effectively than rivals can by enhancing the productivity of firm resources. The mere possession of resources does not guarantee the development of sustainable competitive advantages, as those resources can be traded and are transferable across organizational boundaries. Rather, the capabilities translate those resources into competitive advantages that enable the firm to achieve superior performance, because capabilities are intertwined with tacit knowledge embedded in employees within the organization, and are therefore inimitable and difficult to transfer to other firms (Makadok, 2001).

2.2. Two dimensions of dynamic capabilities

The idea of dynamic capabilities was originated in the strategy field and encapsulated in the classic paper by Teece et al. (1997). This has spawned a number of papers, where the notion of dynamic capabilities has produced some key debates and the general complaint that the concept of dynamic capabilities is far from being consolidated (Barreto, 2010). Despite these debates, we may find an emergent consensus in the literature regarding the essence of dynamic capabilities. Eisenhardt and Martin (2000) argue that integrative capabilities are at the heart of dynamic capabilities. Such integrative capability involves

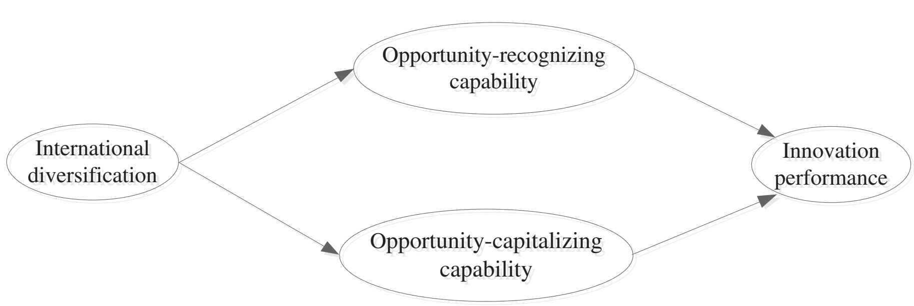

Fig. 1. Research model.