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Revisiting the relationship between product diversification and internationalization process in the context of emerging market MNEs

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ABSTRACT

We examine the contingent effect of existing product diversification on the scope and speed of firms' subsequent internationalization. Understanding these effects is important because prior research on the product—geographic diversification relationship assumes that the relevant decisions are taken simultaneously. This assumption does not apply to firms that consider international expansion only after having grown domestically through product diversification. Drawing on and extending transaction cost logics, we argue that product-diversified firms following geographically diverse and rapid internationalization incur higher transaction costs and are thus less likely to do so. We also find that international experience plays a moderating role.

1. Introduction

International business scholars have become increasingly interested in studying the relationship between product and geographic diversification. Research into this relationship regularly assumes that firms simultaneously determine product and geographic diversification (Geringer, Tallman, & Olsen, 2000; Kumar, 2009; Mayer, Stadler, & Hautz, 2015; Wiersema & Bowen, 2008). At the same time, this research has paid comparatively little attention to the effect of firms' prior diversification on their subsequent diversification decisions, despite indications of path dependence related to firms' diversification strategies (e.g., Hashai & Delios, 2012; Hitt, Hoskisson, & Kim, 1997). Prior diversification is of particular importance when firm diversification has been constrained by the particular institutional context of their home country because this prior diversification affects firms' subsequent diversification.

Research on the internationalization of Latin American firms has stressed that due to their particular institutional context, the strategies of these firms differ from those of firms based in developed or other emerging economies in theoretically significant ways (Bandeira-de-Mello, Fleury, Aveline, & Gama, 2016; Brenes, Montoya, & Ciravegna, 2014; Ciravegna & Brenes, 2014; Ciravegna, Lopez, & Kundu, 2016; Cuervo-Cazurra, 2016; Dominguez & Brenes, 1997). Specifically, as a result of the import substitution policies of many Latin American countries, firms in those countries were initially compelled to grow through product or conglomerate diversification in their home countries (see, for example, Casanova, 2009; Fleury & Fleury, 2011).

When deciding how to expand internationally, these firms thus do not concurrently decide on their level of product diversification but determine their internationalization based on an existing level of product diversification. Yet, we know very little about the effect that product diversification has on the international expansion of mature, late internationalizing firms. Such an effect seems particularly likely when firms aim to grow overseas sales (rather than just source inputs) and when doing so through exports is not possible. Product diversification is thus likely to play a crucial role, especially in horizontal international expansion in the retail sector, where retailers aim to grow overseas sales and exporting is not an option (Alexander, Rhodes, & Myers, 2011).

While an effect of product diversification on geographic diversification is thus particularly likely in the case of retailers, anecdotal evidence has also stressed the importance of time-based competition in retailing and how this is reflected in the often rapid internationalization of fashion retailers, such as Zara (Ghemawat & Nueno, 2006; Quinn & Falley, 2010), and hypermarket chains, such as Tesco and Carrefour (Coe & Hess, 2005; Coe & Wrigley, 2007; Lowe & Wrigley, 2010). In addition to its effect on firms' geographic diversification, we investigate the extent to which product

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diversification affects the speed with which retailers expand overseas. In so doing, we answer calls for more analyses of internationalization speed, an under-researched facet of firms' internationalization process (Casillas & Acedo, 2013). The first research question addressed in this study is thus how product diversification affects the internationalization process of Latin American firms in the retail sector.

Further, recent research into the relationship between product and geographic diversification has highlighted inconsistent findings with regard to the shape of this relationship (Hashai & Delios, 2012; Mayer et al., 2015; Peng, 2001) and has called for more analysis of the roles of firm-level factors that might moderate this relationship (e.g., Kumar, 2009). We suggest that firms' prior international experience moderates the effect of product diversification on geographic diversification and internationalization speed because of the likely effect that international experience will have on the transaction costs associated with the internationalization of increasingly wide product ranges. The second research question we address in this study is thus the question of how firms' international experience moderates the effect of product diversification on Latin American retailers' internationalization process.

By addressing these two research questions from a transaction cost economics (TCE) perspective using data on the internationalization process of the largest Latin American retail MNEs over the 1998–2013 period, our study makes the following contributions to the literature. First, our study contributes to our understanding of the link between product diversification and geographic diversification by investigating situations in which firms do not concurrently determine product diversification and international expansion but in which institutional contexts have led to a historical bias in which firms grow through domestic product diversification rather than through international expansion. Accounting for the idiosyncratic situations of Latin American firms also allows us to contribute to our understanding of how, rather than why, these firms internationalize. Research on this issue remains scarce compared to research on the internationalization of firms from emerging economies in general (Bandeira-de-Mello et al., 2016; Carneiro & Brenes, 2014; Cuervo-Cazurra, 2007; Cuervo-Cazurra, 2008; de Góes & da Rocha, 2015; Lopez, Kundu, & Ciravegna, 2009; Nicholls-Nixon, Castilla, Garcia, & Pesquera, 2011). In so doing, we also respond to calls for more research into the link between product and geographic diversification in the context of firms that are not in advanced stages of internationalization (Mayer et al., 2015; Ramamurti, 2009).

Second, through the examination of the influence of product diversification on internationalization speed as an important, yet often neglected, facet of internationalization, we contribute to a more comprehensive understanding of firm internationalization and its antecedents. Considering the increasing interest of IB researchers in the concept of internationalization speed (Gonzalez-Perez, Manotas, & Ciravegna, 2016; Jiang, Beamish, & Makino, 2014; Mohr & Batsakis, 2016; Vermeulen & Barkema, 2002), we focus on examining a relationship that adds new knowledge to this stream of research and contributes to our understanding of this under-researched facet of firms' internationalization process in the context of firms from emerging economies.

Third, our study contributes to the clarification of the contingent nature of the effects of firms' product diversification on their geographic diversification (e.g., Kumar, 2009) and internationalization speed. Specifically, we enhance our understanding of the effects of product diversification on these firms' internationalization process by underlining the moderating effect of their international experience. By relating firms' international experience to the costs faced by highly product-diversified firms when diversifying internationally, we also contribute to the clarification of the boundary conditions of transaction cost logic in this particular context.

Finally, recent research has called for a greater focus on the industries of firms, given strong indications that internationalization patterns vary across industries (Brandl & Mudambi, 2014; Cuervo-Cazurra & Ramamurti, 2014a). Through our focus on the internationalization of Latin American retailers, we contribute to research that aims to clarify the role of industry-specific characteristics in the internationalization of Latin American firms (see, in particular, Alexander & Silva, 2002; Bianchi, 2009; Brenes, Chattopadyay, Ciravegna, & Montoya, 2014).

We structure our paper as follows. In the next section, we review prior research on the internationalization of Latin American firms before explaining the role of product diversification as an important growth strategy for Latin American firms. On this basis, we then draw on transaction cost logic to explain the effects of product diversification on the geographic diversity and speed of firm's internationalization and to argue for a moderating effect of firms' international experience. We then outline the research setting, context, measurements and empirical methodology of our study before presenting the results of our empirical analysis. After discussing our findings, we conclude by presenting our study's contributions to theory, managerial implications, limitations, and avenues for future research.

2. Research on the internationalization of Latin American firms

Despite the scarce scholarly attention that firms from Latin America have received compared to those from other emerging market regions (Fastoso & Whitelock, 2011; Nicholls-Nixon et al., 2011), recent research has highlighted how the Latin American context makes the analysis of Latin American firms important from both a practical and theoretical perspective (Bandeira-de-Mello et al., 2016; Brenes, Montoya et al., 2014; Ciravegna et al., 2016; Cuervo-Cazurra, 2016; Dominguez & Brenes, 1997). Research has thus begun to pay more attention to the internationalization of Latin American firms, predominantly investigating a) *the factors that allow or prevent Latin American firms from internationalizing*, as well as b) *the process through which Latin American firms expand overseas*. However, as in research on the internationalization of firms from other emerging economies, which has so far focused on the first of these issues (Aulakh, 2007; Cuervo-Cazurra & Ramamurti, 2014b; Cuervo-Cazurra, 2016; Luo & Tung, 2007), we know comparatively little about the nature of the internationalization process of these firms.

Table 1 highlights some of the most important empirical studies on the internationalization of multilatinas (i.e., Latin American MNEs) based on the two aforementioned streams of research (for a comprehensive review of this literature, see Carneiro & Brenes, 2014; Cuervo-Cazurra, 2016).

Research on the first stream of research, i.e., into the *factors that allow or prevent multilatinas from expanding internationally* has stressed the role of particular firm capabilities and resources that are necessary for Latin American firms to internationalize (Aulakh, Kotabe, & Teegen, 2000; de Góes & da Rocha, 2015; Haar & Ortiz-Buonafina, 1995; Thomas, Eden, Hitt, & Miller, 2007). For example, research finds that firms' experiential knowledge (de Góes & da Rocha, 2015), ability to adapt their marketing mix (Aulakh et al., 2000), financial flexibility (Haar & Ortiz-Buonafina, 1995), and country of origin (Fleury & Fleury, 2014) affect whether Latin American firms expand internationally. Research in this first stream has studied firms in multiple sectors based on their membership in the group of the largest Latin American firms (Cuervo-Cazurra & Dau, 2009a, 2009b; Dau, 2012, 2013; Thomas et al., 2007) or has focused on Latin American firms operating in the manufacturing sector (see, for example, Haar & Ortiz-