Pacific Science Review B: Humanities and Social Sciences xxx (2016) 1–9

HOSTED BY

Contents lists available at ScienceDirect

Pacific Science Review B: Humanities and Social Sciences

journal homepage: www.journals.elsevier.com/pacific-science-review-b-humanities-and-social-sciences/

Internationalization and firm performance of Indian firms: Does product diversity matter?

Nufazil Altaf*, Farooq Ahmad Shah [1]

School of Business Studies, Central University of Kashmir, India

A R T I C L E I N F O

Article history:
Received 19 April 2016
Accepted 23 May 2016
Available online xxx

Keywords:
Internationalization
Product diversification
Firm performance
Emerging market

A B S T R A C T

The purpose of this study is to investigate the relationship between internationalization and firm performance and to determine the moderating role of product diversity on this relationship. This study utilizes secondary financial data of 180 Indian manufacturing firms obtained from CMIE PROWESS and pertains to a period of five years. Correlation analysis has been used to make an initial investigation of whether the variables present certain problems of multicollinearity. Pooled Cross-Section/Time-Series regression analysis has been used to test the aforementioned relationships. Results of this study confirm a U-shape relationship between internationalization and firm performance and a significant negative effect of product diversity on firm performance. In addition, results indicate that product diversity strengthens the relationship between internationalization and performance.

1. Introduction

Liberalization, privatization and globalization (LPG) measures adopted by countries all over the globe have led to the reduction in trade barriers and allowed for the smooth flow of goods and services across borders. Due to adoption of LPG measures, a large number of firms in both developing and developed economies are entering global markets to take advantage of the availability of cheap labour, inexpensive land and abundant resources. Recent decades have witnessed rapid growth in international business and because of this rapid internationalization, MNEs now consider the entire world as one market (Hsu, 2006). Accordingly, internationalization is perceived as an important component of corporate strategy that promotes sustained growth (Porter, 1990). Scholars have devoted considerable time and effort to explain the relationship between internationalization and performance (Hitt et al., 2006; Hsu, 2006). However, empirical studies regarding the relationship between internationalization and performance report conflicting results. Studies report two different types of relationships: linear (monotonic) and curvilinear (non-monotonic). With regard to linear (monotonic) relationships, empirical studies have reported negative linear (Singla and George, 2013; Collins, 1990) and positive linear relationships (Hajela and Akbar, 2013; Contractor et al., 2007; Nachum, 2004) between internationalization and firm performance. However, with regard to curvilinear (non-monotonic) relationships, empirical studies have documented U-shaped (Capar and Kotabe, 2003; Ruigrok and Wagner, 2003; Contractor et al., 2003) and inverted U-shaped relationships (Gomes and Ramaswamy, 1999; Hitt et al., 1997; Sullivan, 1994) between internationalization and firm performance. From an extreme perspective, certain studies have reported the existence of an S-curve relationship (Heyder et al., 2011; Ruigrok et al., 2007; Hsu, 2006) between internationalization and firm performance.

In addition, these studies have mostly focused on samples from developed nations. Few studies have examined the relationship between internationalization and performance in emerging Indian market firms (Singla and George, 2013; Hajela and Akbar, 2013; Contractor et al., 2007). Prior studies focused on the examination of the moderating role of exogenous factors (e.g., culture and institutions) on the relationship between internationalization and performance (Li, 2007; Hitt et al., 2006); however, firm-specific factors or endogenous factors (e.g., product diversification, size, and firm-specific assets) have been largely ignored.

This study attempts to fill the research gap by examining the relationship between internationalization and performance in

* Corresponding author. Tel.: +91 9086666846.
E-mail addresses: nahangar113@gmail.com (N. Altaf), farooq_dms@cukashmir.ac.in (F.A. Shah).
Peer review under responsibility of Far Eastern Federal University, Kangnam University, Dalian University of Technology, Kokushikan University.
[1] Tel.:+91 9419073693.

http://dx.doi.org/10.1016/j.psrb.2016.05.002

Indian firms and explaining the moderating role of product diversity (endogenous or firm specific attribute) on this relationship. Accordingly, this study would advance international business literature in following ways. First, unlike previous studies regarding the relationship between internationalization and performance that largely focused on samples from developed nations, this study focuses on firms in an emerging market, India, and thus tests the applicability of the three-stage theory of internationalization in emerging market firms. Second, this study seeks to expand on the divergent results of prior studies regarding the relationship between internationalization and performance. Finally, as argued by Ruigrok et al. (2007) that studies regarding the relationship between internationalization and performance should focus on the role of certain moderating variables, this study adds to existing knowledge and has both managerial and academic relevance. This study explores the moderating role of product diversity on the relationship between internationalization and performance in Indian firms. To the best of our knowledge, this topic has not been yet explored in the Indian context. Furthermore, it must be acknowledged that India possesses certain unique characteristics that provide a natural setting for testing the relationship between internationalization and performance. For instance, among all developing countries, India has altogether different institutional factors such as culture, economic development, and the political and regulatory environment (Singla and George, 2013). Indian multinational corporations (MNCs) face intense competition from foreign MNCs that have developed firm-level capabilities such as adaptive skills, better competitive ability and faster learning (Gaur et al., 2014). Indian MNCs possess comparative advantages that include a competency to successfully manufacture skill-intensive products and services, quality managers and a low cost base (Ramamurti, 2009). All these factors along with the lack of empirical data regarding the relationship between internationalization and performance and the moderating effect of product diversity on this relationship, makes India a unique country for testing these relationships.

This paper is divided into four sections. The “Review of theory and empirical evidence” section contains a brief literature review of theory and empirical results pertaining to the relationship between internationalization and performance and the moderating role of product diversity. The “Methodology” section is an operative component of the study that outlines the methodology employed to arrive at the results. The “Results” section presents empirical results from the analytical tools used in the study. The “Concluding observations” section summarizes the study outcomes.

2. Review of theory and empirical evidence

The phenomenon of internationalization has been discussed broadly in international management literature. For instance, the resource based view (RBV) asserts that “firm as a bundle of resources that are linked together” (Rumelt, 1997). The RBV argues that firm resources determine its international activity. An extension of the RBV is the knowledge based view (KBV) that recognizes firms as knowledge hubs. The KBV implies that learning is central to acquiring the new knowledge and capabilities required to enter international markets (Kuivalainen, 2003). While the RBV and the KBV explain what determines internationalization, the Uppsala school of thought and the New Venture Theory of internationalization explain when firms decide to enter foreign markets. According to the Uppsala school of thought, firms enter foreign markets only when they have an established domestic base (Bilkey and Tesar, 1977). Conversely, the New Venture Theory of internationalization argues that firms internationalize their operations from the beginning (Oviatt and McDougall, 1994). Although these theories provide a possible explanation of what determines internationalization and when firms decide to engage in international business, they fail to explain the possible effects of internationalization on the growth of firms (Zahra, 2005; Sapienza et al., 2006).[2] With regard to the impact of internationalization on firm performance, Li (2007) reports that decisions to enter foreign markets are based on a cost and benefit analysis. This scholar further purports that a firm may benefit from internationalization only when the marginal returns of foreign markets outweigh the marginal returns of domestic markets.

2.1. Benefits and costs of internationalization

The primary logic for internationalizing operations is to explore the unique benefits and minimize costs related to global market participation (Hsu et al., 2013). Prior studies regarding international management demonstrate unique benefits exist for firms[3] adopting the resource based view (RBV) and that resources are heterogeneous with high mobility. The benefits arising from global market participation foster competitive advantage and boost the performance of an organization. Certain benefits of global market participation that have been widely discussed in studies regarding international management follow.

First: Economies of scale occur due to higher factor specialization because of increased production. Higher specialization of factors of production leads to potential cost reductions.

Second: Economies of scope (efficiencies wrought by variety, not volume) occur when a firm is able to jointly produce two or more products cheaper than producing each product individually. Ghoshal (1987) reports that scope economies arise for a diversified firm that possesses the ability to spread investments and costs across the same or different value chains when its non-diversified counterparts cannot.[4]

Third: Learning and innovation benefits occur when a firm conducts business in global heterogeneous markets. The diversity of global markets exposes firms to an assortment of stimuli and provides an opportunity to enhance learning and develop new capabilities that can be then deployed throughout the organization. Thus, international diversity fosters innovation and helps firms achieve positive results in a dynamic environment (Aulakh, 2007; Kim et al., 1993).

Fourth: Access to key resources benefits globally diversified firms because they have access to a greater variety of resources (Kumaraswamy et al., 2012; Laanti et al., 2007; and Zhou et al., 2007). An internationally diversified firm may select a location that provides resources at the lowest possible cost. Nations differ in factor endowments that lead to differences in factor costs. Thus, an internationally diversified firm may configure their value-added chain in such a way that each link is located in the country that results in the least cost for that specific link.

Fifth: Risk reduction benefits an internationalized firm because it may spread its operations throughout multiple countries from where it can retaliate the aggressive moves made by competitors (Kim and Mauborgne, 1988; Hamel and Prahalad, 1985). Operating in multiple markets allows firms to offset the losses of one national

[2] Other theoretical frameworks that explain the process of internationalization are the foreign direct investment theory (Li, 2007); the multinational enterprise theory (Gomes and Ramaswamy, 1999); the organization learning perspective (Ruigrok and Wagner, 2003) and others.

[3] The resource-based view (RBV) implies that a firm can achieve sustained competitive advantage through a unique bundle of resources that are at the core of the firm (Gaur et al., 2014; and Ramamurti, 2009).

[4] Both economies of scale and scope offer benefits that are beyond the potential of product diversification (Caves, 1996).

Please cite this article in press as: Altaf, N., Shah, F.A., Internationalization and firm performance of Indian firms: Does product diversity matter?, Pacific Science Review B: Humanities and Social Sciences (2016), http://dx.doi.org/10.1016/j.psrb.2016.05.002