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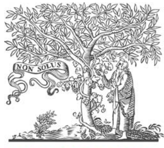

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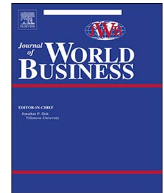

Home country uncertainty and the internationalization-performance relationship: Building an uncertainty management capability

Alvaro Cuervo-Cazurra[a], Luciano Ciravegna[b,d,*], Mauricio Melgarejo[c], Luis Lopez[d]

[a] Northeastern University, D'Amore-McKim School of Business, 360 Huntington Avenue, Boston, MA 02115, USA
[b] King's College, Department of International Development, London, WC2R 2LS, UK
[c] Butler University, Lacy School of Business, 4600 Sunset Ave, Indianapolis, IN 46208, USA
[d] INCAE Business School, Campus Walter Kissling Gam, Alajuela, Costa Rica

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ABSTRACT

We analyze the impact of home country uncertainty on the internationalization-performance relationship of emerging market firms. Building on organizational learning theory and the institutional approach, we argue that internationalization has a positive impact on the performance of emerging market firms, and that this relationship is strengthened for firms based in emerging countries with higher corruption and political risk. The reason is that by being exposed to high levels of home country uncertainty in the form of political risk and corruption, firms develop an uncertainty management capability at home that helps them face the challenges of internationalization better. We also propose that this uncertainty management capability helps emerging market firms perform better outside of their home region. We test our arguments on a sample of 536 firms from Argentina, Brazil, Chile, and Peru.

1. Introduction

The relationship between internationalization and performance has been the subject of a lively debate. On the one hand, operating across borders can benefit firms in different ways, for example by international firms achieving economies of scale, obtaining access to new resources and capital, and acquiring new capabilities (Bartlett & Ghoshal, 1989; Dunning, 1988). On the other hand, internationalizing can also be challenging; firms face new customers and different regulatory environments and need to learn about and undertake additional investments (Hymer, 1976; Johanson & Vahlne, 1977; Zaheer, 1995). As a result, the literature that analyzes the relationship between internationalization and performance has debated the nature of the shape of such relationships, with studies finding positive, negative, U-shaped, inverted U-shaped and sigmoidal relationships (for summaries of the arguments see, for example Glaum & Oesterle, 2007; Contractor, Kundu, & Hsu, 2003; Contractor, 2012; Lu & Beamish, 2004; Marano, Arregle, Hitt, Spadafora, & van Essen, 2016). Despite the wealth of analyzes, however, there is still debate on the actual drivers of the relationship between the level of internationalization and performance (Hennart, 2012). Additionally, many studies analyze firms from advanced economies, which may confound some of the relationships, because such firms tend to have particular home-based advantages that support their internationalization; in contrast, enterprises from emerging economies have to deal with weak or dysfunctional institutions (Aulakh, Kotabe, & Teegan, 2000; Contractor, Kumar, & Kundu, 2007; Gaur & Kumar, 2009; Khanna & Palepu, 2010; Peng, Wang, & Jiang, 2008). We suggest this may alter the relationships and logics identified in previous studies.

Hence, in this paper we contribute to the literature by analyzing the impact of internationalization on the performance of emerging market firms, proposing that this relationship changes with home country uncertainty. We draw on organizational learning theory (Argote, 1982; Fiol & Lyles, 1985) and the institution-based view (Khanna and Palepu, 2010; Meyer, 2001; Brouthers, 2002; Peng, 2001; Peng et al., 2008) to put forward three arguments. First, we explain how emerging market internationalized firms perform better than domestic firms. Second, we propose that this relationship is strengthened for firms based in emerging countries with higher uncertainty, specifically higher corruption (Beets, 2005; Cuervo-Cazurra, 2016; Tanzi, 1998) and higher political risk (Henisz, 2000; Kobrin, 1979). The reason is that these firms develop an uncertainty management capability, whereby home country uncertainty leads firms to go through organizational learning and become apt at surviving and thriving in emerging markets where regulatory frameworks and conditions are not very transparent and can change abruptly (Khanna & Palepu, 2010), thus becoming flexible,

* Corresponding author.
E-mail addresses: a.cuervocazurra@neu.edu (A. Cuervo-Cazurra), Luciano.ciravegna@kcl.ac.uk (L. Ciravegna), mmelgare@butler.edu (M. Melgarejo), Luis.lopez@incae.edu (L. Lopez).

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adaptable and resilient (Ciravegna & Brenes, 2016). Their capability to deal with political risk is useful when internationalizing as they face political systems and conditions that differ markedly from those at home, enabling them to adapt better to these different political systems as well as to manage abrupt changes. Their capability to face corruption in their home context becomes useful to manage uncertainty in foreign markets regarding the application of rules and regulations.

Third, we propose that firms perform better when they expand in the nearby region, but the uncertainty management capability has a higher impact when they expand outside their home region. Firms tend to expand within the same region because they can benefit from entering markets that are similar to the home country along multiple dimensions, as first postulated by the incremental internationalization model (Johanson & Vahlne, 1977) and later by scholars of regional studies (Rugman & Verbeke, 2004). Countries differ within regions, but inter-regional differences are greater, suggesting that outside of the home region a firm will find it necessary to make greater adjustments than when operating in its home region (Rugman & Verbeke, 2008; Verbeke & Kano, 2016). However, unlike firms based in advanced economies, firms based in emerging markets may suffer from both country-level (Madhok & Keihany, 2012) and regional-level location disadvantages (Ciravegna, Lopez, & Kundu, 2014). The reason is that they are likely to be based in regions affected by high uncertainty, which entail a high cost of doing business (Hennart, 2012; Hymer, 1976), as well as unsophisticated factor markets, which limit the scope for specialization and increase the cost of accessing strategic resources (Cuervo-Cazurra, 2012). Thus, those that have developed an uncertainty management capability are better positioned at dealing with the challenges of expanding outside the home region.

We test these ideas on a sample of 536 publicly-traded Latin American firms based in Argentina, Brazil, Chile, and Peru. Analyzing firms in Latin America provides a novel research setting as these firms have received very limited attention in the literature (Elahee & Vaidya, 2001; Ciravegna, Lopez, & Kundu, 2016; Pérez-Batres, Pisani, & Doh, 2010); 67% of the multinationals from Latin America are based in the four countries we examine (Cuervo-Cazurra, 2016). These countries provide us with an interesting sample because of the diversity in political risk and corruption and, at the same time, a degree of commonality (Aguilera, Ciravegna, Cuervo-Cazurra, & Gonzalez-Perez, 2017; Bulmer-Thomas, 2003). We find that internationalization has a positive impact on firm performance, especially for firms that internationalize regionally within Latin America. We also find that the internationalization-performance relationship is stronger for firms that come from countries with higher levels of political risk. Finally, we find that the impact of home country political risk on the internationalization-performance relationship is stronger when firms internationalize beyond their home region of Latin America.

These ideas and findings contribute to a better understanding of the internationalization-performance relationship in two ways. First, rather than discussing the specifics of the shape of the relationship as done elsewhere (Contractor et al., 2003; Lu & Beamish, 2004), we go deeper into the factors that modify this relationship, as called for in previous studies (Hennart, 2012). We explain how organizational learning from the home context modifies this relationship by leading firms to develop an uncertainty management capability that is helpful for internationalizing. These arguments provide additional empirical support for the idea that emerging market firms build advantages from their exposure to disadvantageous home country conditions and leverage these lessons to support their internationalization (Cuervo-Cazurra, 2012; Cuervo-Cazurra & Genc, 2008). Specifically, we add a more fine-grained view of how political risk and corruption influence the internationalization-performance relationship. We find that only political risk positively moderates the relationship, suggesting that it is by managing high political risk that firms acquire the uncertainty management capability that supports their performance when internationalizing.

The ideas and findings also contribute to the literature on the internationalization of emerging market firms (Aulakh et al., 2000; Brenes, Chattopadyay, Ciravegna, & Montoya, 2014; Contractor et al., 2007; Cuervo-Cazurra & Ramamurti, 2014; Lopez, Kundu, & Ciravegna, 2009; Luo & Tung, 2007; Ramamurti, 2012; Wright, Filatotchev, Hoskisson, & Peng, 2005). We show that extra-regional expansion has positive effects on performance, possibly because it allows firms to diversify from regional-level uncertainty, such as regional waves of political risk, while allowing for the deployment of their uncertainty management capability in contexts where incumbents have different capabilities.

These ideas also have important implications for managerial practice. Understanding whether and how internationalization affects performance for firms based in different home country contexts is key for managers of firms that have to design and implement internationalization strategies (McGahan & Victer, 2010). This study provides insights to managers of emerging market firms by proposing that they actively learn from the uncertainty coming from political risk and corruption at home and use this uncertainty management capability to address the differences across countries in which their firms internationalize. Managers can also use this uncertainty management capability to manage in countries that are farther away from the home country, and realize that the challenges faced at home can become a source of advantage abroad that help their firms perform better.

2. Theory and hypothesis development

2.1. Uncertainty management capability

We link organizational learning theory (Argote & Miron-Spektor, 2011; Fiol & Lyles, 1985) and the institutional perspective (Khanna & Palepu, 2010; Meyer, 2001; Peng et al., 2008) to analyze the relationship between internationalization and performance; we propose that firms develop an uncertainty management capability from dealing with corruption and political risk at home that alters the internationalization-performance relationship. We study uncertainty focusing on political risk (Henisz, 2000; Kobrin, 1979) and corruption (Rose-Ackerman, 1975; Tanzi, 1998), analyzing how they moderate the relationship between internationalization and performance. We choose these two dimensions because they represent important and yet different manifestations of home country uncertainty. Although the underlying logic is similar, the two dimensions follow different mechanisms: while political risk deals with uncertainty about the political environment, corruption generates uncertainty with regards to whether and how rules are interpreted and enforced (Cuervo-Cazurra, 2006; Rose-Ackerman, 1975).

Organizational learning theory points out that knowledge can be discrete and contextual (Argote, 1982; Levitt & March, 1988). Discrete knowledge is specific and applicable to very similar situations, such as a firm based in a high political risk country that operates in foreign countries with high political risk. Contextual knowledge is broader, applicable in a less specific but more generalizable way to situations that share some common feature, for example, in our case, abrupt changes in regulation, which, though typical of corrupt and politically risky markets, can affect all economies. The organizational knowledge that firms accumulate to become more resilient because of domestic market uncertainty, and that forms the base of the uncertainty management capability, helps them in similar, high-uncertainty markets, where they can deploy it discretely (Fiol & Lyles, 1985).

Firms develop capabilities as their managers and employees learn by accumulating experiential knowledge. Firms that have to operate in environments that change often, where crises are the norm, develop routines and processes to manage uncertainty, as part of their building of an institutional capability (Martin, 2014; Oliver, 1997). Operating in high uncertainty domestic markets, firms develop strategic solutions to become more resilient, such as having redundant capacity and

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