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Organizational performance feedback effects and international expansion

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ABSTRACT

Drawing on performance feedback theory to develop the Uppsala internationalization model, we argue that organizational performance relative to managerial aspirations influences firms' foreign expansion propensity as well as the type of country location. Our statistical analysis of foreign entries by Japanese machinery firms between 1976 and 2002 finds that firms performing closer to aspirations were more likely to enter foreign countries than those that under- or out-performed. Underperforming firms were also more likely to enter countries with greater cultural and geographic proximity to those in which they had already invested. Our findings contribute to international business research by identifying organizational performance conditions under which firms tend to adopt an incremental approach to foreign expansion, or else a comparatively radical one of selecting more distant or unfamiliar countries.

"*Mr. Schultz [the CEO of Starbucks] says the company has turned its fortunes around, allowing it to now shift its attention to international markets*."

Wall Street Journal, 04/14/2010

"*Virginia-based AES Corp., which has missed its recent earnings targets, has scaled back its expansion goals and is selling some of its foreign assets*."

Wall Street Journal, 11/30/2001

1. Introduction

International expansion is often cited as a means by which firms can improve financial performance. Investments in new jurisdictions enable firms to achieve global economies of scale, access local endowments, technologies and markets, as well as exploit proprietary knowledge, all of which have the potential to yield greater profits and growth rates. Entering foreign countries, however, is a risky proposition as the well-documented losses, and eventual exits of AES Corporation in Georgia, Tesco in Japan, and Wal-Mart in Germany, all of whom were successful in their home markets, illustrate (Christopherson, 2007; Sonne, 2012; Zaheer, 1995).

A dominant theory of firm internationalization – the Uppsala model (Johanson & Vahlne, 1977, 1990, 2009) – argues that firms assess and respond to foreign entry opportunities and risks by drawing on prior organizational experience: prior international experience reduces uncertainty about market environments in a jurisdiction, increasing the attractiveness of investing further in existing foreign markets or of entering new countries similar to those in which the firm is already experienced (Eriksson, Johanson, Majkgard, & Sharma, 1997; Figueira-de-Lemos, Johanson, & Vahlne, 2011). Empirical studies have provided support for the thesis that prior experience abroad positively stimulates re-investment as well as entry into similar countries (Barkema, Bell, & Pennings, 1996; Casillas & Moreno-Menendez, 2014; Chang, 1995; Jiang et al., forthcoming; Mitra & Golder, 2002).

While the Uppsala model provides insights into how organizational experience can shape firms' international expansion, it does not account for managerial cognitive mechanisms that may influence how risk-reward tradeoffs are evaluated in the context of foreign entry. Here, we build on the Uppsala model by adopting a cognitive approach to managerial decision-making (March & Shapira, 1987; Shapira, 1995), drawing specifically on performance feedback theory (Cyert & March, 1963; Greve, 2003b). Highlighted as one of the key domains of organization theory development in a recent review (Lounsbury & Beckman, 2015), performance feedback research proposes that managerial propensity to undertake organizational change and to assume new risks depends, in part, on organizational performance relative to managerial aspirations. An aspiration has been defined as "the smallest outcome that would be deemed satisfactory by the decision maker" (Schneider, 1992, p. 1053). In this view, divergence of actual performance from aspiration levels of performance affects managerial allocation of attention, the scope of search for alternative courses of action, learning behavior, and willingness to make risky change.

In this study, we focus on two critical aspects of

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internationalization, namely the overall propensity for foreign expansion and the choice of investment location. We argue that as performance either increases above or decreases below aspiration levels, firms become less likely to enter foreign countries. Performance that exceeds aspiration levels can increase managerial resistance to change proposals, diminishing the willingness to search for and undertake new foreign ventures. On the other hand, while performance that falls short of aspiration levels may motivate managers to change their strategic tactics (Lages, Jap, & Griffith, 2008; Lages, Mata, & Griffith, 2013), constraints on organizational resources and restrictions on information processing – which become more acute as performance deteriorates – tend to inhibit new foreign entries (D'Aveni, 1989; McDonald & Westphal, 2003; Ocasio, 1995; Staw, Sandelands, & Dutton, 1981). Hence, firms are most likely to enter new countries when performance is close to aspirations. We argue that performance also influences the *types* of country that firms are likely to enter: as performance diverges further from aspiration levels, managers tend to increasingly rely on prior organizational experience to guide foreign location choices, selecting countries that are culturally more similar and geographically more proximate to existing subsidiary locations.

We test our predictions using data on new entries into foreign countries by the population of firms in the Japanese machinery industry over a 26-year period. Consistent with our expectations, we found a robust relationship between financial performance relative to aspiration levels and foreign entry propensity: firms were most likely to enter new countries when performance was close to historical or social aspiration levels, and to forego international expansion when performance was significantly below or significantly above aspirations. In addition, when performance is below aspiration levels, firms tended to concentrate new entries in countries that were culturally and/or geographically closer to their existing country locations.

Responding to calls for more research on decision-making heuristics in the process of MNE foreign expansion (Aharoni, Tihanyi, & Connelly, 2011), our analysis contributes to international business research by developing novel predictions that use a cognitive approach to managerial decision-making to examine how firms assess and respond to the risks of entering new foreign countries. We provide empirical evidence that organizational performance relative to aspirations, which shapes managerial attitudes towards risk and organizational change, influences foreign entry propensity and country location choices. Overall, our findings suggest that cognitive influences on managerial risk-taking can have substantive implications for the dynamics of firms' internationalization processes, a rich topic for further research.

2. Theoretical background and hypothesis development

2.1. Theoretical background

Building on the behavioral theory of the firm (Cyert & March, 1963), the Uppsala model portrays firm internationalization as an incremental process driven by the interplay between experiential learning about foreign markets and organizational commitment of resources (Figueira-de-Lemos et al., 2011; Johanson & Vahlne, 1977). Initially, when firms have little experience in or knowledge of foreign markets, they tend to mitigate foreign investment risks by entering countries that are culturally similar and geographically closer to their home. As firms gradually learn from experience how to operate in foreign environments, they search for new opportunities and expand into locales that are similar to prior entries, but which may be increasingly distant from their original home country (Casillas & Moreno-Menendez, 2014; Johanson & Wiedersheim-Paul, 1975; Mitra & Golder, 2002). In this paradigm, organizational learning founded on search in the neighborhood of prior experience is the prime driver of strategic change.

The Uppsala model is consistent with Cyert and March's (1963) view of managerial decision-making that business managers are often risk averse and "avoid risk by using short-run reaction to short-run feedback rather than anticipation of future events" (March & Shapira, 1987, p. 1410). Most internationalization research also assumes managerial risk aversion, predicting that firms tend to commit greater resources to international markets when uncertainty about foreign markets is reduced as a result of knowledge accumulation (Figueira-de-Lemos et al., 2011). Although scholars have noted that underlying risk preferences or tolerances may in fact vary (Johanson & Vahlne, 1977, p. 30), empirical research in the field has largely overlooked antecedents that may cause a shift in attitudes towards risk and organizational change.

By contrast, a considerable body of research has examined the cognitive foundations of managerial decision-making and the factors that affect how managers perceive, assess, and respond to change proposals (Gavetti, Greve, Levinthal, & Ocasio, 2012; March & Shapira, 1987). In particular, performance feedback theory argues that an organization's performance relative to aspiration levels affects managerial interpretation of whether performance is deemed satisfactory, and therefore regulates managerial risk preferences and acceptance of risky alternatives (Greve, 2003b). Organizational performance can thus shift managerial risk thresholds when performance exceeds or falls short of aspirations, either stimulating or deterring risk-taking behavior.

Performance feedback research has also explored how managerial search routines and learning behaviors are conditioned by organizational performance relative to aspirations, arguing that cognitive factors can generate biases in how managers discover and interpret information (Audia, Locke, & Smith, 2000; Baum & Dahlin, 2007). For instance, information derived from prior organizational experience may be evaluated quite differently, depending on whether performance is deemed to be satisfactory or unsatisfactory, yielding varying predictions about the impact of prior experience on subsequent organizational change. In comparison, the Uppsala model assumes that organizational learning and search processes occur in a quasi-automatic fashion, in which managers absorb new knowledge arising from international experience, and then proceed to search for and evaluate new foreign investment opportunities (Johanson & Vahlne, 1990).

While performance feedback theory has yielded new insights into several dimensions of organizational strategy such as R&D investment (Alessandri & Pattit, 2014; Chen & Miller, 2007), capital expenditure (Audia & Greve, 2006; Desai, 2008) and acquisitions and alliances (Lohrke, Kreiser, & Weaver, 2006; Ruth, Iyer, & Sharp, 2013), it has not yet been applied to internationalization process. A few studies have examined how MNEs' domestic market share and corporate financial performance influence the overall degree of geographic diversification (Jung & Bansal, 2009; Mascarenhas, 1986; Rose & Ito, 2008). Scholars have also explored how changes in export performance affect international marketing tactics, such as product adaptation and pricing (Lages et al., 2008; Lages et al., 2013). However, none have theorized how performance relative to aspiration levels affects foreign country entry, an important yet typically complex and risky component of MNE strategy. Therefore, incorporating a performance feedback perspective into the analysis of foreign expansion decisions can not only shed new light on the development of a firm's internationalization path, but also extend the domain of extant performance feedback research.

2.2. The impact of organizational performance relative to aspirations on foreign entry

The performance feedback literature argues that when organizational performance exceeds socially- or historically-determined aspiration levels, managerial openness to organizational change tends to diminish. Socially-based aspirations are organizational targets for performance determined by comparisons with the performance of peer firms (such as firms in the same industry), while historically-based aspirations are performance targets benchmarked against a firm's own performance record over previous periods (Greve, 1998).

In outperforming firms managers are argued to become resistant to change for cognitive reasons such as increased risk aversion (Shinkle,

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