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Experiential drivers of foreign direct investment by late-comer Asian firms: The Chinese evidence☆

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ABSTRACT

Focusing on the cognitive process of managerial decision making, we argue that both organizational and personal international experiences contribute to managerial knowledge structure which in turn influences firms' foreign direct investment decisions. Given the decision task context of late-comer Asian firms, the two types of experiences can lead to decision outcomes that compete for limited decision making resources, and therefore their interaction effect is expected to be negative. Based on a sample of 164 Chinese electronic manufacturing firms over an eight-year period (2001–2008), we found substantial support for our hypotheses. While both organizational and personal international experiences increase the foreign direct investment propensity of a firm, these experiences also weaken each other's effects.

1. Introduction

Recent years see a phenomenal growth of foreign direct investment (FDI) by firms from Asian emerging economies (EEs) (Buckley et al., 2007; Jormanainen & Koveshnikov, 2012). Unlike their developed country counterparts, being "later-comers" (Bartlett & Ghoshal, 2000) to the global market, these Asian firms face dual competitive pressures for short-term survival and long-term sustainable growth (Rui & Yip, 2008; Yamakawa, Peng, & Deeds, 2008). The weak market institutions in these emerging economies also impose constraints on firms' strategic behaviors and their access to critical resources (Cui & Jiang, 2012; Peng, Wang, & Jiang, 2008). When making FDI decisions, these dual competitive pressures and institutional constraints result in increased decision task urgency and reduced decision making resources, which have consequences on firms' utilization of experiential knowledge. While such consequences can potentially explain the special characteristics in EE firms' internationalization that deviate from conventional theoretical prediction, they have, however, not been systemically studied in the literature.

The existent literature highlights two perspectives of experiential drivers of FDI. An organizational perspective recognizes firm's prior foreign market experience as a key driver of firm's entry and increasing commitment in foreign markets (Johanson & Vahlne, 2009; Peng, 2001). An upper-echelon perspective focuses on the firm's managerial resources and experience that support its growth in international markets (Daily, Certo, & Dalton, 2000; Reuber & Fischer, 1997). The literature however lacks an integrative framework to examine the simultaneous and interactive effect of both types of experiential drivers. The existent literature are also mainly validated in a developed country context, which does not take into consideration the special decision-making context faced by Asian emerging economy firms. To fill these research gaps and to better understand the internationalization process of Asian firms who are facing decision task urgency and limitations of decision making resources, this study adopts a managerial cognition perspective to examine the roles that organizational and managerial international experience play in firms' FDI decision makings, both *independently* and *interactively*.

A managerial cognition perspective focuses on the role of experiential knowledge in the decision making process (Nadkarni, Herrmann, & Perez, 2011; Stubbart, 1989; Walsh, 1995). Based on this perspective, organizational practice and managerial personal experience can both contribute to the formation of a knowledge structure that guides the information processing and analysis by managers during FDI decision-making. Organizational international experience is embedded in the organizational structure, resources, and path of internationalization, which supports a path-dependent decision outcome. Managerial international experience, on the other hand, can be obtained from diverse international activities of top managers which are unrelated to the focal firm, and therefore supports an adaptive decision outcome. Both organizational and managerial

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international experience can enhance a firm's ability to process foreign market information and, as a result, increase its propensity to conduct FDI. However, given the constrains related to decision task urgency and decision resource limitations faced by EE firms, the path-dependent and adaptive decision making mechanisms are likely to compete for limited managerial attention and decision-making resources, and thus weaken the effects of each other (Bogner & Barr, 2000; Lurigio & Carroll, 1985; Nadkarni et al., 2011).

This study uses the Chinese context as its empirical ground. Being the leading emerging economy in Asia and the world, the Chinese context provides a variety of firms with different levels of international experience. Managers in these firms are also of diverse backgrounds, ranging from former government bureaucrats to local entrepreneurs and overseas returnees, all with different levels of international exposure. Such large variations in organizational and managerial international experience provide an ideal empirical setting for this study. Using longitudinal data covering a period of rapid growth of Chinese outward FDI (2001–2008), this study examines the effects of firms' experiential drivers using an event history analytical method.

2. Theoretical framework

2.1. Types of experiential driver of FDI

Two streams of prior studies examine the experiential drivers of FDI. One stream focuses on organization-level experience from an organizational learning perspective, while the other adopts an upper echelon perspective to investigate the effect of managers' personal experience.

The organizational stream includes the process model of internationalization, organizational learning theory, and the transaction cost economy. The process model of internationalization states that firms' growth into foreign markets requires both foreign market-specific knowledge and general knowledge of international business operations, and that firms gain such knowledge through prior business experience (Johanson & Vahlne, 1977, 2009; Pehrsson, 2008; Peng & Fang, 2010). The organizational learning theory explains experiential effects on a wider range of organizational decisions and actions. Applying this theory to the FDI behavior of firms, researchers find that firm-specific international experience increases the likelihood of foreign market entry through FDI (Martin & Salomon, 2003; Thomas, Eden, Hitt, & Miller, 2007). Based on transaction cost economy, Anderson and Gatignon (1986) discuss the effect of international experience on the level of uncertainty in FDI transactions and the desired level of control in a firm's foreign operations. International experience enhances a firm's ability to accurately predict foreign risks and returns and thus reduces the level of internal uncertainty, which in turn increases the likelihood of high commitment foreign market entry.

The upper echelon stream focuses on managerial resources and explains the relations between top management team (TMT) demographic characteristics and various important organizational outcomes (Carpenter & Fredrickson, 2001; Wiersema & Bantel, 1992). The main theoretical arguments of these studies do not differ in principle from those of the organizational stream regarding the role of international experience in reducing the costs and uncertainty associated with FDI. These studies focus, however, on managers as contributors of heterogeneous personal international experience (Carpenter & Fredrickson, 2001; Reuber & Fischer, 1997; Sambharya, 1996; Tan & Meyer, 2010), which are beyond the common “organizational code” (March, 1991).

2.2. An integrative framework from a managerial cognition perspective

Managerial cognition is the central building block of the behavioral theory of strategy (for in-depth review, please see Brandenburger & Vinokurova, 2012; Gavetti, 2012; Powell, Lovallo, & Fox, 2011). From a managerial cognition perspective, experiential knowledge needs to be processed and analyzed in a sense-making mechanism before leading to a decision outcome (Meindl, Stubbart, & Porac, 1994; Walsh, 1995); and such a process is influenced by decision task characteristics and decision making resources (Posner, 1982; Simon, 1991). In the context of FDI decision making, organizational and managerial international experience can contribute to the diversity and intensity of decision makers' knowledge structures about foreign markets and operations. A high level of diversity and breadth of information in the knowledge structure reduces reliance on existing knowledge and leads to adaptive sense-making. This mechanism encourages top managers to experiment with new strategies (Bogner & Barr, 2000; Nadkarni et al., 2011), such as exploration-oriented FDI. In contrast, great intensity and depth of information in the knowledge structure promote path-dependent sense-making in which top managers attempt to fit new stimuli into their existing mindsets (Kiesler & Sproull, 1982; Lyles & Schwenk, 1992). Emphasizing the utilization of existing knowledge and routines, this mechanism encourages exploitation-oriented FDI. The adaptive and path-dependent sense-making mechanisms may conflict with each other when decision makers are under time pressure from the decision task and have limited resources to support different types of decision outcomes. In such a situation, trade-offs may needs to be made, and as a result, the effect of certain experiential knowledge may not be fully realized.

3. Hypothesis development

3.1. Independent experiential effect

International experience from an organizational origin comprises organizational memory about foreign markets and foreign operation. Organizational memory can be stored in the minds of individual members of an organization as well as in the organization's culture, structure, and process (Meindl et al., 1994; Walsh, 1995). Top managers can access this organizational memory to build their knowledge structures, which guide their information processing and decision making for future foreign market entries.

The most relevant experience for future foreign market entry through FDI is accumulated through a firm's prior FDI activities. As Johanson and Vahlne (1977) point out, experiential knowledge about foreign markets and foreign operation cannot be easily acquired; rather, it must be gained through actual operations in foreign markets. As a firm accumulates experience through operating in a foreign country and becomes more familiar with its market conditions, it develops processes and methods to evaluate and meet the needs of foreign customers, to estimate costs and returns, and to assess the economic worth of that foreign market (Emden, Yaprak, & Cavusgil, 2005; Erramilli, 1991). Furthermore, by entering and operating in a foreign market, a firm can gain knowledge about the formal and informal aspects of the institutional environment of the host country. With this knowledge, the firm can make strategic responses to the institutional pressures from the host country (Oliver, 1991), attain institutional legitimacy (Chan & Makino, 2007), and eventually reduce its liability of foreignness (Kostova & Zaheer, 1999; Zaheer, 1995). The accumulated knowledge about a foreign market and its institutional environment can reduce uncertainty associated with operating in that foreign market and consequently increase the likelihood of the firm entering similar foreign markets in the future.

Hypothesis 1. An EE firm's prior FDI experience is positively related to the propensity of the firm conducting FDI.

The cognitive mindsets of managers (and human beings in general) are influenced by their backgrounds and life experiences (Sambharya, 1996). When making business decisions in a complex information environment, managers draw on their personal experiences that are relevant to the decision task to form a cognitive map that facilitates attention allocation, information interpretation, and speedy problem solving (Walsh, 1995).