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The influence of managerial discretion, innovation and uncertainty on export intensity: A real options perspective

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ABSTRACT

Geographic sales diversification (i.e., exports) is a multidimensional phenomenon that has primarily been examined using a single theoretical perspective drawn from international trade or organizational strategy. This study uses managerial discretion, real options, and innovation literatures to examine the roles of managers, context, and environment in motivating geographic sales diversification. We contribute to the international business and organizational strategy literatures by highlighting how the combination of managerial discretion, capacity to offer innovative products, and uncertainty can motivate export-driven internationalization.

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1. Introduction

Although the diversification of sales markets through exports is a complex strategic decision influenced by many factors, it has primarily been analyzed using a theoretical lens taken from either the literatures of international trade or organizational strategy. One influential perspective that identifies the drivers of geographic sales diversification (i.e., exports) is the sequential approach to internationalization which builds on product life cycle and international trade concepts to explain the process of internationalization (Cavusgil, 1984; Johanson & Vahlne, 1990; Johanson & Wiedersheim-Paul, 1975; Mudambi & Zahra, 2007). This theory suggests that firms with innovative products will establish themselves in their respective domestic markets before expanding internationally; usually by exporting to foreign markets (Johanson & Vahlne, 1990; Mudambi & Zahra, 2007).

Conversely, organizational strategy literature has historically relied on transaction cost economics (TCE) to explain the process of geographic sales diversification as part of internationalization strategy (Boisot & Child, 1996; Chi & McGuire, 1996). TCE highlights the difficulties of writing, executing, and monitoring contractual arrangements with international partners (Oxley, 1999; Williamson, 1985). It focuses on the contractual hazards and opportunistic behavior that can surface

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among exchange partners due to uncertainty, information asymmetry, and difficulty enforcing contracts (Verwaal & Donkers, 2002; Zacharakis, 1997).

Though either perspective may explain a choice of modes for internationalization, the consensus among scholars is that internationalization is a complex, multidimensional phenomenon; and a more complete picture will emerge by incorporating the role of managerial discretion in the process (Chi & McGuire, 1996; Crossland & Hambrick, 2011; Oviatt & McDougall, 2005; Reuer & Tong, 2005). Indeed, the role of the top management team (TMT) cannot be overestimated in terms of strategic decisions such as internationalization (Crossland & Hambrick, 2011; Hambrick & Finkelstein, 1987). As a result, managers require high levels of discretion in order to pursue certain modes of internationalization such as geographic sales diversification. However, the literature has yet to focus its attention on how managers with decision-making latitude may leverage contextual and environmental factors such as innovation levels and uncertainty to pursue geographic sales diversification (Leonidou, 1998; Shaver, 2011; Zahra, Ireland, & Hitt, 2000). In sum, the role of managerial discretion along with contextual and environmental factors in affecting geographic sales diversification has remained understudied (Crossland & Hambrick, 2011; Leonidou & Katsikeas, 1996; Salomon & Shaver, 2005).

This study draws on managerial discretion, real options, and innovation literatures to explore the motivations for geographic sales diversification. Our theoretical framework is developed around one overarching theme: greater managerial discretion, combined with certain industry contextual and environmental variables, motivates a greater reliance on exports as a growth option. Our hypotheses are tested using a large sample of U.S. manufacturing industries, based on their degree of variance, in terms of both managerial discretion and innovation (Hambrick & Abrahamson, 1995; Silverman, 1999). Industry-level analysis is chosen because firms in an industry often share attributes that allow for the aggregation of firm effects and the development of a composite model (Klein, Dansereau, & Hall, 1994). Indeed, industry exports are a key international trade metric that is universally reported by such national agencies as the U.S. Bureau of Economic Analysis.

Our contribution to the extant literature involves developing an integrated theoretical model used to examine the role of managers, context (i.e., level of innovations) and environmental pressures (i.e., uncertainty) in explaining variance in the level of exports. This study applies the insights of strategic choice and environmental determinism perspectives to the internationalization process, and is one of the first to draw on the theoretical underpinnings of real options and managerial discretion views to propose that managers require considerable freedom and authority over firm resources and structure to make internationalization-related decisions (notable exceptions include Tong, Reuer, & Peng, 2008; Crossland & Hambrick, 2011). We further contribute to the literature by highlighting the role of contingencies in affecting the relationship between managerial discretion and industry exports.

We begin with a brief review of the literature, including real options, managerial discretion and innovations. Next, we discuss their relevance within the context of internationalization, particularly industry exports. This is followed by developing hypotheses and discussing methods. We conclude with presenting results, discussion, and implications.

2. Literature review

This study underscores how managerial discretion, industry innovations, and uncertainty motivate geographic sales diversification for a number of reasons: first, a theoretical gap exists in the literature regarding how managers with decision-making latitude leverage contextual factors (Leonidou, 1998; Shaver, 2011; Zahra et al., 2000). Though the role of the top management team (TMT) is critical, managerial discretion, combined with contextual and environmental factors, has been understudied in the literature (Crossland & Hambrick, 2011; Leonidou & Katsikeas, 1996; Salomon & Shaver, 2005). Next, we highlight the role of innovation as a key contextual variable that facilitates internationalization (Hitt, Hoskisson & Kim, 1997; Porter, 1998). Industry innovations endow key managers with unique product offerings, giving them the leeway to pursue internationalization through products with the potential to deliver competitive advantage in the global marketplace (Hitt et al., 1997; Porter, 1998). Third, we emphasize the role of uncertainty as a key environmental contingency that may influence managers who distribute risk by diversifying into international markets. By integrating such variables into our theoretical framework, we respond to the call for a deeper examination of the role of managers and innovation in the internationalization process (Bernard & Jensen, 2004; Leonidou, 2004; Lohrke & Bruton, 1997; Salomon & Shaver, 2005) and as a consequence, we propose that industries where levels of managerial discretion, innovation, and uncertainty are high will show greater geographic sales diversification.

In the context of geographic sales diversification, the use of real options lens is particularly applicable because exports is generally an entry-level strategy that further provides an option for enhancing commitment using modes such as international joint ventures (IJV), foreign direct investments (FDI), and acquisitions, all fraught with higher levels of uncertainty and complexity than exports (Johanson & Vahlne, 1990; Leonidou & Katsikeas, 1996; Oviatt & McDougall, 2005). At the same time, scholars have argued that in itself, exporting is a complex strategic decision that is influenced by the uncertainties of foreign markets with their different social, political, monetary and legal systems (Oxley, 1999; Pla-Barber & Alegre, 2007; Salomon & Shaver, 2005; Shaver, 2011; Zacharakis, 1997). For domestic U.S. managers, weighing the tradeoffs between risk and expected returns from less familiar and distant markets is relatively more challenging since the U.S. is not only the largest global producer of innovative products but the largest consumer of them as well (Segal, 2004). A viable alternative to industry exports is an increased focus on the large U.S. home market (Bernard & Jensen, 2004; Salomon & Shaver, 2005). Managers thus face a number of options for boundary expansion in lieu of exports, e.g., using other modes or a greater focus on the domestic U.S. market.

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