Journal of World Business 50 (2015) 793–803

Contents lists available at ScienceDirect

Journal of World Business

journal homepage: www.elsevier.com/locate/jwb

Political strategies, entrepreneurial overconfidence and foreign direct investment in developing countries

Stefan Heidenreich [a], Alexander Mohr [b,1], Jonas Puck [a,*]

[a] WU Vienna University of Economics and Business, Institute for International Business, Welthandelsplatz 1, 1020 Vienna, Austria
[b] Kent Business School, University of Kent, Canterbury, Kent CT2 7PE, United Kingdom

ARTICLE INFO

Article history:
Available online 4 April 2015

Keywords:
Entrepreneurial internationalization
Uncertainty
Decision-making
Political strategies
Entrepreneurial overconfidence

ABSTRACT

Foreign investors in developing countries are exposed to comparatively high levels of environmental uncertainty and often use political activities to manage this uncertainty. At the same time, international entrepreneurs seek out uncertain environments, because of the potential opportunities and upside potential associated with uncertain situations. We investigate the interplay between political strategies and entrepreneurial overconfidence in managing environmental uncertainty based on an in-depth case study of an entrepreneurial foreign direct investment (FDI) project in Ghana. Our results provide insight into the individual and combined roles that political strategies and entrepreneurial overconfidence can play in international entrepreneurial decision-making in highly uncertain environments. In particular, we find that the adoption of political strategies can exacerbate entrepreneurial overconfidence and affect the survival of an investment.

1. Introduction

As a consequence of the economic liberalization in many developing and transition economies (UNCTAD, 2010; UNIDO & UNCTAD, 2011), an increased interest in these environments can be detected from both investors and academia. From the perspective of firms or entrepreneurs based in developed economies, most developing economies differ considerably from their home economies in terms of economic, regulatory-political, and socio-cultural conditions. In addition, the environment in developing economies is not only different from the environment in developed countries, but also tends to be less stable and predictable than that in developed economies. Both, the (institutional) distance between developed and developing countries as well as the country-specific contextual conditions thus raise the uncertainty for companies from developed countries operating in developing countries (e.g., Yan & Luo, 2001).

Uncertainty in developing countries arises not only as a result of the behavior of market actors such as, for example, customers and suppliers, but to a significant extent from the behavior of socio-political stakeholders, in particular, host country governments. Firms can reduce the level of uncertainty by shaping their interaction with such actors. Prior research suggests that the inadequate integration of governments, non-governmental organizations and other relevant groups into the overall strategy can cause major business-critical problems (e.g., Baron, 1995a,1995b; Hillman & Wan, 2005; Shaffer, 1995; Wartick & Wood, 1998; White, Boddewyn, & Galang, 2015). Based on the relevance of such non-market forces in general, and in emerging and developing countries in particular, (e.g., Baysinger, 1984; Blumentritt & Nigh, 2002; Meznar & Nigh, 1995) research has identified various political strategies to engage socio-political stakeholders in international markets (e.g., Hillman, Zardkoohi, & Bierman, 1999; Holtbrügge, Berg, & Puck, 2007; Lord, 2000). These strategies are used by firms not only "to reduce uncertainty [and] to mitigate or eliminate perceived threats", but also "to create opportunities in their environments" (Lord, 2000, p. 76), and derive advantages from uncertainty (Heidenreich, Puck, & Filatotchev, 2014; Schuler, Rehbein, & Cramer, 2002). Given the high uncertainty associated with investing in developing economies, political strategies are thus likely to be of particular importance for firms investing in these countries. Yet, there has been very little research into the relationship between political strategies and its consequences for subsidiaries in developing and transition economies (for exceptions, see Hillman et al., 1999; Keim & Baysinger, 1988; Puck, Rogers, & Mohr, 2013; or Elg, Ghauri, & Tarnovskaya, 2008).

* Corresponding author. Tel.: +43 1 31336 4318.
E-mail addresses: A.T.Mohr@kent.ac.uk (A. Mohr), jonas.puck@wu.ac.at (J. Puck).
[1] Tel.: +44 1227 82 4615.

http://dx.doi.org/10.1016/j.jwb.2015.03.002
1090-9516/

In addition, given that uncertainty involves both downside risks but also upside potential (see, for example, Di Gregorio, 2005; Nordal, 2001), we suggest that investments in developing countries are particularly attractive to entrepreneurs. Entrepreneurs have been characterized as having (1) "a high level of energy" needed to cope with uncertainty and sustain their core business idea (Sexton & Bowman, 1985, p. 136); (2) a strong belief in their own abilities to exploit identified opportunities as well as the tendency to ignore or downplay the associated downside risk (Brockhaus & Horwitz, 1986); and, (3) a high degree of flexibility and adaptability in their decision-making, which allows for rapid responses to exploit emerging opportunities and tackle unexpected changes in the environment (Fredrickson & Mitchell, 1984). Research in entrepreneurship has also highlighted the importance of various cognitive biases, in particular, entrepreneurial overconfidence that affect entrepreneurial decision-making (e.g. Cooper, Woo, & Dunkelberg, 1988; Gudmundsson & Lechner, 2013). Although the potential cognitive biases of decision-makers have long been acknowledged in research on the internationalization of firms (Aharoni, 1966), based on their recent review of research into this topic, Aharoni, Tihanyi, and Connelly (2011) find that the international business literature has not yet fully appreciated the role and ramifications of decision-makers' cognitive biases for explanations of firm internationalization. For instance, Aharoni et al. (2011) found "no research that specifically addresses the role of managers in the entry mode decision process".

We thus suggest that by investigating the role of entrepreneurial confidence, as a cognitive bias in the context of an entrepreneurial FDI project, our study contributes to overcoming this lack of research into the role of such biases in international managerial decision-making. There are strong grounds to believe that the use of political strategies as well as cognitive biases of entrepreneurs play a role in the initiation, maintenance and possible termination of an overseas investment, because both affect the uncertainty decision-makers associate with an investment project. Yet, the potential interdependence between the use of political strategies and cognitive biases of entrepreneurs in the context of entrepreneurial FDI has so far not been scrutinized in detail. Against this background, we address the following research question: *How do the use of political strategies and entrepreneurial overconfidence individually and jointly affect entrepreneurial decision-making when investing and operating in highly uncertain environments?* We investigate this question on the basis of an in-depth analysis of the development of a failed entrepreneurial FDI project in a highly uncertain environment. Our fine-grained analysis of the decisions taken and the events that occurred over the lifetime of this FDI project allows us to track the individual and combined roles of political strategies and entrepreneurial overconfidence in the decision-making processes shaping the development of an overseas venture from its initiation to its demise (Aharoni et al., 2011).

The remainder of the article is structured as follows: in the next section we review the literature on the two core concepts in this study, i.e. entrepreneurial overconfidence and political strategies. We then explain and justify our research design and present our case study in the form of a chronological sequence of episodes. In the subsequent section, we analyze the individual and combined roles of the use of political strategies and entrepreneurial overconfidence in our case and relate our findings to prior research. We conclude the paper by highlighting the study's implications for research and practice and directions for future research.

2. Conceptual background

Foreign firms investing in developing countries are faced with comparatively high levels of uncertainty. Unlike risk, which tends to be exclusively associated with negative connotations and with costs, rather than the mere unpredictability of outcomes (March & Shapira, 1987), the term uncertainty comprises such (downside) risks but also upside potential (Di Gregorio, 2005; Nordal, 2001). This is also in line with Knight (1921), who suggested that uncertainty also creates opportunities for profit: "With uncertainty entirely absent, every individual being in possession of perfect knowledge of the situation, there would be no occasion for anything of the nature of responsible management or control of productive activity" (Knight, 1921, p. 267). Consequently, and in line with the existing literature, we view uncertainty as a situation in which decision-makers lack the knowledge for making a fully informed decision and in which environmental developments are likely to affect the outcomes of previously made decisions negatively (downside risk) or positively (upside potential).

In the context of overseas investments uncertainty can arise from a variety of sources, including the market, political-regulatory, or socio-cultural environment in a particular host country. The uncertainty associated with, for example, political volatility, complex and nontransparent regulatory frameworks and corruption, tends to be significantly higher in developing as compared to developed economies (Lecraw, 1991; Mmieh & Owusu-Frimpong, 2004). We thus suggest that firms and entrepreneurs from developed countries face particularly high levels of uncertainty when investing in such markets. Prior research has argued that both the existence of various biases of decision-makers, in particular, entrepreneurial overconfidence as well as the adoption of political strategies affect the level of uncertainty that firms and individuals associate with operating in a particular environment (Aharoni et al., 2011; Puck et al., 2013; Schuler et al., 2002).

2.1. Uncertainty and entrepreneurial overconfidence

Based on our characterization of investments in developing economies as being associated with comparatively high levels of both downside risks as well as upside potential, we suggest that developing economies are a particularly fertile ground for entrepreneurial investments. This is because entrepreneurial activity tends to be associated with comparatively higher levels of risks and is thus geared toward exploiting such situations (Hébert & Link, 1988; McMullen & Shepherd, 2006; Miller, 1983). Nevertheless, entrepreneurial decision-making is arguably especially challenging in the case of uncertain markets (Alvarez & Barney, 2005). The assumption that entrepreneurs generally bear greater risks (e.g., D'Amboise & Muldowney, 1988), but benefit from these "risk-taking efforts" (Covin & Slevin, 1989, p. 77) has generated an intense debate since more recent research (e.g., Miner & Raju, 2004; Palich & Bagby, 1995) has questioned the risk-taking propensity of entrepreneurs. Rather than consciously taking greater risks, entrepreneurs may cognitively frame a certain situation in a different way than non-entrepreneurs who "may not share this 'rose garden' view, leading them [the non-entrepreneurs] to react more cautiously" (Palich & Bagby, 1995, p. 427). Cooper et al. (1988) found that entrepreneurs show a significant degree of optimism or "entrepreneurial euphoria" because they are often unable to objectively evaluate their own strengths and weaknesses. In turn, optimism and overconfidence in one's own abilities lead to an evaluation of "smaller perceived downside risks and greater perceived chances of success" (Koellinger, Minniti, & Schade, 2007).

2.2. Uncertainty and political strategies

The higher levels of risk firms encounter in developing economies as compared to developed countries also makes firms