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# Operating internationally—The impact on operational performance improvement

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ABSTRACT

In this paper we investigate how the level of international presence impacts the operational performance improvement of companies. We identify three parts of international nature: source internationally, manufacture internationally and sell internationally. Each of these bricks can contribute to lower costs through scale economies. Moreover, more people can create more knowledge, higher production volumes lead to better understanding of processes, and thus better quality. But being global also has some drawbacks. Logistics and coordination costs, as well as investment costs due to large and productive machinery can increase; long internal and external supply chains lengthen delivery times, increase risks and reduce flexibility. So in total, it is not evident at all, that being multinational results in higher operational performance improvement, even if these companies' business performance is usually higher than their competitors'. Analysis is made using the Fifth Edition of the International Manufacturing Strategy Survey (IMSS). It includes 725 companies of 21 countries. According to our results being international in itself does not help in improving operational performance. Consistent strategy and improvement programs are needed. Further important research implication is that due to the complexity of operating internationally configuration approaches, such as cluster analysis might give a more valuable picture than looking at simple variable level relationships.



## 1. Introduction

We can see a diversity of international activities of firms. Start-up companies and well-established giant multinationals work through international links, integrated into internal and external company networks. It is difficult to follow why and how companies make decision on sourcing and sales directions, locate their new alliances in a given area (Martin et al., 1998); why some parts of a product are replaced somewhere else to produce, or outsourced to external partners.

The main drivers for companies to establish subsidiaries abroad are to get access to low cost factors, to important markets or to skills and knowledge (Ferdows, 1997; Vereecke and Van Dierdonck, 2002). Their basic motive is to match the double criteria of global integration and local responsiveness, in order to reach both efficiency and customer satisfaction. They develop capabilities stemming from their global nature (Shi and Gregory, 1998; Roth et al., 1991).

Internationalization happens through export–import activities, or through establishing foreign manufacturing facilities (Shi, 2003; Abele et al., 2008). Thus, in order to detect the status of internationalization we have to analyze export–import and international manufacturing activities. Companies usually start the process of internationalization by export–import activities to get knowledge first about their potential markets and suppliers (Johanson and Vahlne, 1977). After initial learning and enough financial background they can set up manufacturing establishments abroad or form formal relationship with foreign partners.

We assume that companies decide to become international in order to win something from this: it can be simply survival, or finding new challenges in the lack of opportunities in domestic markets, but crossing boarders can easily pay off in higher competitiveness (Han et al., 1998) and in higher business performance (Hitt et al., 2006).

The level and kind of international activities varies. Some companies rely heavily on international sourcing but produce and sell almost exclusively on the domestic market. Others use the other side of the value chain: they source and manufacture domestically, but try to sell their products on the international market. This variety of combinations implies that being a domestic or international player is not advantageous or disadvantageous in itself. Benefits depend on strategies, organizational structures, operations behind their moves (Roth et al., 1991, Roth, 1992), as well as on contextual factors (Bausch and Krist, 2007).

This complexity is rarely analyzed, however. Value chain elements are usually discussed separately in the literature (Roth,

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1992). Furthermore, international business research is inclined to see internal operations of companies as black boxes (Coe et al., 2008). The same is true at the performance side. Although business performance of international companies is usually discussed (Hitt et al., 2006), operational, nonfinancial performance (Dibrell et al., 2005), and functional consequences (Annavarjula and Beldona, 2000) are less so. Thus it is a relevant research question to see what the typical geographical combinations of these value chain elements (source, manufacturing, sales) are, and how successful they are in operational performance improvement terms.

In this paper we consider an activity domestic, if it takes place within the borders of one country. International activities, on the other hand, cross borders. International activities have two levels: they can take place within one region (within one continent), or in more than one region. The former is called regional, the latter is considered global.

This study is completely exploratory in nature. We explore empirically if internationalizing leads to higher rate of improvement in operational performance of companies and also we discover the characteristics of the most typical levels of internationalization in source–manufacturing–sales configurations. The fifth round of the International Manufacturing Strategy Survey is used for the investigation.

First the literature on internalization and globalization is reviewed shortly and we set our research questions. It is followed by describing the research methodology and the used database. After categorizing companies on their level of internalization in source–manufacturing–sales configurations research questions are examined and discussed. The paper is closed with conclusions and limitations.

## 2. Literature review and research questions

International business refers to all those business activities which involve cross border transactions of goods, services, resources between two or more nations (Joshi, 2009). So operating internationally does not necessarily mean that companies have to establish manufacturing plants abroad. Sourcing from international suppliers or delivering products to foreign markets also satisfy the criteria of becoming international (Annavarjula and Beldona, 2000). Analyzing the advantages and drawbacks companies face when they spread their activities internationally give also the reasons why they go abroad and develop international networks.

Basically, there are location-specific (comparative) and firm-specific (competitive) advantages (Roth, 1992) of international diversification. Fahy (2002) also mentions that advantages can stem from both the home and host country environment. Many authors provide lists of the advantages and drawbacks associated with international operations. Typical advantages of going international include (a) lower prices due to lower material and factor costs in sourcing countries (Ferdows, 1997; Kumar, 1998), which is the most common motive of foreign direct investment in developing countries (Colotla et al., 2003); (b) larger volumes achieved through economies of scale and scope by centralizing procurement (Bozarth et al., 1998), distribution, or producing global products (Cooper and Kleinschmidt, 1985; Roth, 1992; Shi and Gregory, 1998); (c) higher quality due to larger competitive base of potential suppliers and/or more demanding customers (Gereffi et al., 2005); (d) specific products or conditions due to comparative advantage of some regions (e.g. industrial districts, history, geography), for example eyewear from Italy (Nassimbeni, 2003); (e) access to technology and knowledge (e.g. through worker skills or joint ventures) (Ferdows, 1997; Mitchell et al., 1992); (f) access to market, which might require local production to build trust (if people inclined to domestic products) (Dubois et al., 1993) or which is due to protectionist activities (e.g. government requirement for local content); (g) sometimes, companies do not have choice. If they do not find domestic suppliers or domestic markets, they are forced to go abroad (Nassimbeni, 2006; Bausch and Krist, 2007).

Having several subsidiaries can provide wider, network level positive impacts, as well (Mitchell et al., 1992; Roth, 1992; Shi and Gregory, 1998). Multinational companies can reach volume economies (scale, scope and learning), can create an international intelligence system in R&D and manufacturing knowledge, and can stabilize sales by gaining operational flexibility in manufacturing planning (Pontrandolfo and Okogbaa, 1999) and technology replacement. They can also play off tax rate differentials and reach organizational advantages through sophisticated structure and control system (Roth et al., 1991). Presence of subsidiaries in many countries can help to gain and share knowledge how to handle different situations.

Expansion, however, can have disadvantages, as well, especially for companies, which cannot rely on wide networks. International purchasing and sales, for example increase the purchasing and selling costs, difficulties and uncertainties by (a) tax and customs, (b) exchange rates, (c) language barriers, (d) contractual problems due to different laws in various countries, (e) longer distances (Bozarth et al., 1998) as compared to stay with domestic sources and sales. These potential drawbacks can eliminate the original cost advantages and definitely reduce delivery reliability and speed. Becoming larger and multinational, can further complicate organizational structures, create complexity and confusion and increase coordination costs. Cultural diversity can have negative impact by creating communication, coordination, and motivation problems (Mitchell et al., 1992).

At business level there seems to be positive relation between internationalization and business performance (Hitt et al., 2006), although the relationship is context dependent. According to Bausch and Krist (2007) R&D, product diversification, country of origin, company age and company size are important influencing factors. Grant (1987) also found, that although "*straight comparisons typically show MNEs* (*multinational enterprises – author's remark*) *to be more profitable than domestically-based firms, but once the effects of other variables are taken into account, overseas production tends to be either insignificantly or negatively related to growth and profitability*." (p. 79). Moreover, the relationship is probably not linear (Gomes and Ramaswamy, 1999).

Although the majority of papers deal with the actual performance, some of them mention the importance of dynamic perspectives. Grant (1987) argues that a dynamic formulation eliminates the influence of variables, whose levels are comparatively constant over the period (e.g. R&D or advertising intensity). Gomes and Ramaswamy (1999) writes about strong bias on static snapshots. Colotla et al. (2003) emphasize the importance of improvements, since competitors also improve their own performance. So looking at changes and actions, as well as performance improvements might be more important for future competitiveness than current practices and performances. Cooper and Kleinschmidt (1985) found that export growth (the dynamic measure) is strongly related to export strategy, while static export measures depend more on company contingencies. That is, companies can more affect growth than static performance with their strategy.

Important deficiency of the current literature on internationalization and international networks that it does not go beyond business level measures (Annavarjula and Beldona, 2000). Functional, operational, non-financial performance indicators are rarely taken into account Venkataraman and Ramanujam (1986), and