Journal of World Business 46 (2011) 185–193

Contents lists available at ScienceDirect

Journal of World Business

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

The role of top management team international orientation in international strategic decision-making: The choice of foreign entry mode

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ARTICLE INFO

Article history:
Available online 11 June 2010

Keywords:
Top management team
Nationality diversity
International experience
Foreign entry mode
International strategic decision-making
Multilevel

ABSTRACT

By applying the upper echelons perspective to international strategic decision-making, we examine the impact of managerial characteristics on the choice of foreign entry mode. We distinguish between top management team (TMT) international experience and nationality diversity and propose the latter as a central yet understudied aspect of TMT composition that influences international decision-making with regard to choice of entry mode in a unique way. Our results show that while TMTs with international experience are more likely to choose full-control entry modes over shared-control entry modes, nationally diverse TMTs are more inclined to opt for shared-control over full-control entry modes when entering foreign markets. This highlights the need to treat TMT nationality diversity and international experience as two distinct characteristics influencing international strategic decision-making.

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1. Introduction

The international business literature traditionally assumes that internationalization decisions are purely rational and scholars tend to ignore strategic decision-making research in explaining how foreign investment decisions are made (Brouthers & Hennart, 2007). Foreign expansion does not occur in a vacuum, however, but is determined by a certain set of strategic choices made my executive decision-makers. Yet, past research primarily focuses on the rational, measurable attributes of the transaction without considering the top management team (TMT) as decision-maker. While empirical research on entry mode choice for foreign direct investments (FDI) has identified and tested numerous predictor variables, such as firm, industry and country characteristics (for reviews, see Brouthers & Hennart, 2007; Kumar & Subramaniam, 1997), it largely neglects to account for the individuals and teams making the actual decisions (for notable exceptions, see Herrmann & Datta, 2002, 2006 on the role of CEO characteristics).

Based on the behavioral theory of the firm (Cyert & March, 1963; March & Simon, 1958), strategic decision-making research focuses on how decisions are conditioned by bounded rationality of individuals. For instance, upper echelons theory suggests that executives' backgrounds and experiences greatly influence their interpretations of strategic decision-making situations, and, in turn, affect their choices (Hambrick & Mason, 1984). A large body of research has linked manager's education, functional background, age, tenure, etc. to a number of strategic outcomes. Lately, this line of enquiry has been extended to the global arena. The increase in market globalization over the past decades and the ensuing pressures on top management to internationalize their firms puts a premium on decision-makers with international orientations.

Internationally oriented TMTs are believed to be better at coping with diverse cultural, institutional, and competitive environments and make strategic decisions that result in superior performance (Bartlett & Ghoshal, 1989; Gupta & Govindarajan, 2002) than domestically oriented TMTs. Research has linked TMT characteristics, particularly international experience, to firm international involvement (Athanassiou & Nigh, 2002; Reuber & Fischer, 1997; Sambharya, 1996; Tihanyi, Ellstrand, Daily, & Dalton, 2000). Yet, the potential value of heterogeneity in executive's nationalities and the cultural composition of the TMT has thus far been neglected, constituting a critical omission in our understanding of international strategic decision-making.

While both international experience and nationality diversity are likely to influence international decision-making, they lead to different preferences and strategic choices. Specifically, whereas international assignment experience brings benefits such as international market knowledge, skills, and informal network contacts to the decision-making process, such experiences are limited in time and scope (Caligiuri & DeSanto, 2001). Nationality, on the other hand, influences the fundamental values and cognitions of the decision-maker, which are used as lenses to

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doi:10.1016/j.jwb.2010.05.003

scan, identify, organize, interpret, and utilize information, which, in turn, provides the basis for strategic choice (Shaw, 1990). The values embedded in national cultures have a profound and enduring effect on executives' orientations, independent of the logics and wisdom accrued in management development. In a TMT setting, the *diversity* in cognitive bases and values resulting from executive nationalities has a strong influence on strategic decision-making.

The contribution of this paper is threefold. First, we integrate entry mode theories with the upper echelons perspective in order to illuminate the role of managerial characteristics in international entry mode decisions. While existing TMT research focuses primarily on the role of TMT (and CEO) characteristics in determining firm internationalization, the composition of the TMT has not been explicitly linked to the choice of foreign entry mode. By the same token, entry mode research has considered a range of factors at country, industry, and firm level to influence the entry mode decision, however, largely ignoring the influence of the managerial team making such decisions.

Second, our paper compares and contrasts two specific characteristics relevant to firm internationalization: TMT international experience and nationality diversity in order to illustrate their distinct roles in international strategic decision-making. Specifically, we argue that TMT international experience and nationality diversity influence the perception of risks associated with entering foreign markets differently, thereby leading to different preferences for modes of entry. Our results demonstrate that TMT nationality diversity is positively associated with a preference for shared-control entry modes, such as international joint ventures (IJVs), whereas internationally experienced TMTs are more likely to prefer full-control entry modes, such as greenfield or acquisitions, as mode of entry into foreign markets.

Third, as entry mode choice is influenced by variables at multiple levels (e.g., country, industry, firm and decision) it can be considered a multilevel phenomenon (Arregle, Hebert, & Beamish, 2006). Parent firms can have multiple foreign direct investments and hence these cannot be considered as independent. We use hierarchical linear modeling (HLM) to account for the nested structure of the data and thus contribute to the growing literature utilizing multilevel theory and method in international business research.

2. Theory

2.1. International entry mode choice

One of the fundamental questions in international business is how firms expand beyond their national borders. A number of theories have been applied to explain the entry mode decision. Transaction cost (TC) and institutional theory are among the most commonly used theories (Brouthers & Hennart, 2007). Much of this literature is grounded in economic theory with a strong focus on rational choice in relation to cost-minimization and risk-adjusted return on investment (e.g., Anderson & Gatignon, 1986; Hennart, 1988; Williamson, 1985).

According to TC theory, the choice between full and shared ownership of an affiliate depends on the costs and benefits of sharing its equity relative to those of retaining full ownership (Hennart, 1988; Williamson, 1985). When market transactions or contracts are subject to high transaction costs, sharing equity is efficient because it aligns the incentives of the parties and thus reduces the risk of opportunism. In line with this view, the literature suggests that different modes of foreign entry represent different levels of resource commitment, risk, and control (Anderson & Gatignon, 1986). Accordingly, a joint venture (JV) is the pooling of assets in a common and separate organization by two or more firms, resulting in lower commitment and *shared* ownership, risk, and control. Wholly owned subsidiaries (WOS), on the other hand, are chosen when firms seek *full* control and are willing to make maximum commitment and take on maximum risk (Kogut & Singh, 1988).

Several arguments have been advanced to explain why shared-control entry modes are relatively less risky than full-control modes. First, in joint ventures (JVs) equity is shared among partners. This limits the risk of each partner to their share of the investment. In comparison, greenfield and acquisitions entail higher commitment of resources and investments in order to assure full ownership and operational control. While such full-control entry modes may result in potentially higher returns, such returns are accompanied by greater risk (Agarawal & Ramaswami, 1992).

Institutional theory (North, 1990) has recently been applied to the entry mode decision as an extension to TC theory. According to this view, environmental uncertainty is an important factor influencing foreign market entry. Institutional and cultural context variables determine such uncertainty and are included alongside traditional transaction cost variables to explain entry mode choice. Building on new institutional theory (Scott, 1995), Yui and Makino (2002) examined the impact of regulatory, cognitive and normative dimensions of host country institutional environment on entry mode choice while controlling for TC variables and found all three dimensions to exert direct influence on entry mode choice. In addition, the cultural distance between home and host country may influence managerial cost and uncertainty evaluations in target markets (Kogut & Singh, 1988). The greater the cultural distance the higher the perceived environmental uncertainty and risk of foreign direct investments.

Full-control modes of entry are more vulnerable to environmental uncertainties and risks because they are less flexible and involve higher irreversible investments (Hill, Hwang, & Kim, 1990). As environmental uncertainty increases, firms may choose lower-control governance modes over full-control modes in order to limit the risk exposure and increase operational flexibility (Gatignon & Anderson, 1988; Kim & Hwang, 1992; Luo, 2001). At the same time, risk and cost associated with cultural distance between host and target countries may be mitigated by shared ownership (Slangen & van Tulder, 2009).

2.2. Managerial characteristics and behavioral strategic decision-making

Prior entry mode studies are grounded in rational choice models and lack attention to the role of managerial characteristics. In contrast, the behavioral theory of the firm (Cyert & March, 1963) recognizes the influence of bounded rationality on the part of decision-makers. It emphasizes experiential learning as the driving force behind the internationalization process of the firm (Johanson & Vahlne, 1977). According to the behavioral theory of internationalization, managers search in the neighborhood of their past experiences and, as a result, firms tend to stay in the vicinity of their past practices and the routines which govern them. Decisions on how to enter foreign markets are characterized by complexity, incomplete information, and uncertainty related to anticipated outcomes. Under these conditions, decision-makers' backgrounds and experiences are likely to have an important influence on such decisions (Hambrick & Mason, 1984).

The most fundamental challenge faced by top managers is to process many, complex, and often ambiguous stimuli when making strategic decisions under high uncertainty (Starbuck & Milliken, 1988). In such situations, the stimuli do not clearly point

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