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Performance effects of international expansion processes: The moderating role of top management team experiences

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ABSTRACT

This study investigates how experience of top management teams (TMTs) influences the performance effect of added cultural distance in international expansion processes. Taking a dynamic perspective, we focus on internationalization processes and the cultural distance that is added in expansion periods. We argue that a TMT's experience can help in coping with the complexities of added cultural distance. Based on information-processing theory, we hypothesize and find that international experience and shared team-specific experience of a TMT positively moderate the relationship between added cultural distance and firm profitability. We test our hypotheses based on cross-sectional time-series data on 3656 expansion steps of 80 German firms during the 1985–2007 period.

1. Introduction

International business scholars have long been interested in the performance effect of international expansion. A large number of studies have investigated the impact of a firm's multinationality or degree of internationalization at a certain point in time on its profitability. However, empirical studies taking such a static perspective have yielded decidedly mixed results, including U-shaped, inverted U-shaped, S-shaped, and both positive and negative linear relationships (for recent overviews see Contractor, Kundu, & Chin-Chun, 2003; Hitt, Tihanyi, Miller, & Connelly, 2006; Li, 2007; Verbeke, Lei, & Goerzen, 2009). Little research has taken a dynamic perspective and investigated the impact of characteristics of the process of internationalization on the profitability of multinational enterprises (MNEs) (Vermeulen & Barkema, 2002). The process of internationalization, however, is important because expanding a firm's international scope is even more complex than managing an MNE in its current state (Mishina, Pollock, & Porac, 2004). Accordingly, our results show that it is not only the *level* of cultural diversity at a certain point in time that affects firm performance but also the *process* of how this level has been achieved over a period of time. In addition, we even find that level and change in cultural diversity may actually have different effects on firm performance. This indicates that the two aspects actually constitute theoretically distinct sources of complexity, which both should be distinguished and incorporated in the study of international expansion.

When first entering a foreign country, firms face liabilities of foreignness or outsidership (Johanson & Vahlne, 1977, 2009). They need to adapt to the unfamiliar locations and integrate new foreign subsidiaries into their existing international operations (Meyer, Mudambi, & Narula, 2011). At the same time, profitable firm growth is limited in a period of time

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(Penrose, 1959). Firms are constrained in their ability to expand and successfully cope with complexity added in the internationalization process in a limited period of time (Tan, 2003). For example, Vermeulen and Barkema (2002) and Wagner (2004) find that if firms expand too fast, i.e., undertake too many internationalization activities per period of time, their efficiency will suffer. Besides the mere number of expansion steps, the added complexity, and hence the additional costs of expanding internationally vary with the distance between newly entered markets and markets where the firm already has a presence (Ghemawat, 2001), with cultural distance, i.e., differences in national cultures between countries, being recognized as a particularly important source of complexity (e.g., Gomez-Mejia & Palich, 1997; Verbeke et al., 2009; Yu, Subramaniam, & Cannella, 2009).

In this paper, we take a dynamic perspective and specifically focus on change. We investigate time periods and the cultural distance added by international expansion steps undertaken in those periods to address our first research question: *What is the impact of complexity in the form of the amount of cultural distance added in a period of international expansion on the profitability of the expanding MNE?*

However, we believe that a central contingency factor in the empirical analysis of performance effects of internationalization has been largely neglected: the firm's management. It is highly relevant as complexity added in the international expansion process comes with additional information processing requirements for managers (Penrose, 1959). We believe that, in particular, a firm's top management team can make a difference since coordinating change and making strategic decisions, like expansion into foreign countries, is usually the task of the strategic apex of the organization (e.g., Barkema & Shvyrkov, 2007; Hambrick, Cho, & Ming-Jer, 1996; Mintzberg, 1971). Thus, it is the TMT that faces information processing requirements in the internationalization process, i.e., the need to gather, share, and attend to information, and then jointly analyze and integrate it as a team to handle complexity (Hinsz, Tindale, & Vollrath, 1997).

Experience of the top management team affects its knowledge and its information processing ability, and as such its performance as a unit (Hambrick & Mason, 1984; Kor, 2003; Stewart, 2006). As a consequence, such experience influences the team's ability to reap the benefits and cope with the costs of international expansion resulting, for instance, from cultural distance. In this way, top managers' experience may moderate the performance effect of international expansion processes in general, and added cultural distance, in particular. Nonetheless, the role of top managers in dealing with change has received limited empirical attention in this context. This is especially surprising as multiple studies have made arguments based on managerial resources and limitations, which are key to Penrose's theory of the growth of the firm (1959), and yet they often do not include this aspect in the empirical analysis. As Hennart's review (2007) concludes, the "literature underplays the role of management". In this paper, we directly address this issue with our second research question: *How can experience of a firm's top management team moderate the relationship between added cultural distance – being one source of complexity in a period of international expansion – and firm profitability?*

2. Theoretical background and hypotheses

2.1. Complexity and the role of cultural distance in international expansion processes

A theoretical rationale for both, benefits and costs of international expansion abound. On the one hand, potential benefits may accrue from influencing market forces (Kogut, 1985), reducing transaction costs (Buckley & Casson, 1976; Hennart, 1977, 1982), learning about foreign markets (Barkema & Vermeulen, 1998), or from transferring and exploiting firm- and subsidiary-specific advantages internationally (Rugman & Verbeke, 2001; Verbeke, 2009). On the other hand, while managing an MNE in its current state is by itself a complex task, managing its expansion is even more difficult (Mishina et al., 2004). In contrast to the majority of prior studies, our theoretical reasoning focuses on the latter in order to investigate the performance effects of international expansion from a dynamic perspective.

In an internationalization period, MNEs often undertake multiple expansion steps. Hence, they have to cope with the complexity and the associated costs resulting from all these steps (Vermeulen & Barkema, 2002). This complexity arises, on the one hand, simply from the mere increase in the number of subsidiaries located in different environments (Daft, 2009; Fredrickson, 1986). On the other hand, the degree of complexity depends on the extent to which these various locations differ from each other. Hence, not every expansion step adds the same amount of complexity in a specific expansion period. Therefore, the complexity which an MNE is exposed to due to an international expansion step varies with the *distance* between the newly entered market and markets where the firm already has a presence (Ghemawat, 2001; Gomez-Mejia & Palich, 1997). Expansion steps into very different terrains from the ones already known are likely to require extensive assimilation and adaption of structures, systems, and processes. Though such adaptation to unfamiliar local settings and the simultaneous coordination with existing activities are sources of additional complexity, they are usually required if the firm is to survive and compete in foreign markets (Benito, 2005; Zaheer, 1995). Operating for the first time in a new environment, MNEs usually need to gradually learn and develop capabilities to overcome liabilities of foreignness and outsidership (Johanson & Vahlne, 2009) while simultaneously integrating the new entity in the MNE's network of subsidiaries (Barkema, Bell, & Pennings, 1996). The relevant knowledge about new markets and the appropriate skills to operate in them, however, can often only be acquired through a complex and time-consuming process.

Extensive research has shown that a particularly important source of complexity in the international expansion process is the *cultural distance* between newly entered markets and markets in which a firm is already active (e.g., Gomez-Mejia & Palich, 1997; Yu et al., 2009). The term cultural distance refers to differences in national cultures between countries. It has