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Strategic Patterns of Internationalization and Performance Variability: Effects of US-Based MNC Cross-Border Dispersion, Integration, and Outsourcing

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ABSTRACT

This paper examines how the performance variability of an MNC is affected by the strategic patterns it has used to expand abroad. The paper uses data from the Bureau of Economic Analysis annual surveys of U.S. companies with affiliates abroad to empirically support the hypotheses that: (a) cross-border geographic dispersion contributes to a decrease in performance variability; (b) cross-border integration contributes to an increase in performance variability; and (c) outsourcing contributes to a decrease in performance variability. Furthermore, the combined effects from the interaction of these strategic patterns are found to increase performance variability.

1. Introduction

The international management and international business literature has engaged in an extensive debate on whether there exists a causal effect (and if so, the nature of this causal effect) between degree of internationalization and performance. The literature also includes significant work establishing linkages between performance variability and degree of internationalization as a one-dimensional construct. What has been less investigated empirically is the impact of internationalization as a multidimensional construct on performance swings, e.g., the effect of corporations' strategic patterns of internationalization on the *variability* of performance. This paper has the objective of contributing to this debate by examining how the performance variability of multinational companies (MNCs) is affected by three strategic patterns of internationalization which result from managerial choices.

A firm's past exposure to risk may be estimated by observing the variability of its performance over time. A majority of the empirical studies examining risk have used measures based either on the variability of accounting returns, mostly ROA or ROS, or the covariance of market returns, mostly systematic risk (please see Ruefli et al., 1999 for a review). Firms with higher exposure to risk will likely suffer higher performance variability over time. Conversely, firms with stable performance outcomes are more predictable and less likely to face financial distress problems. Performance variability provides a necessary input for the development and execution of company strategies because managers make business decisions and investors make asset allocation decisions with constant attention to the relationship between risk and return. These decisions are a function of both exogenous drivers (dependent on conditions external to the firm) and endogenous drivers (dependent on conditions internal to the firm). It is necessary for managers and investors alike to understand how strategic patterns of internationalization may affect a firm's risk profile. This knowledge can help managers reduce the firm's exposure to risks resulting from internationalization decisions.

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The three overarching research questions investigated herein are: (a) whether a strategic pattern of internationalization with a higher degree of cross-border dispersion contributes to lower performance variability over time; (b) whether a strategic pattern of internationalization with a higher degree of cross-border integration contributes to higher performance variability over time; and (c) whether a strategic pattern of internationalization with a higher degree of outsourcing contributes to lower performance variability over time. Broadly stated, it is expected that firms engaging in significant horizontal cross-border dispersion experience lower performance variability, or, in other words, a negative effect on variability of performance is expected from geographic dispersion. It is also expected that firms with greater integration of cross-border activities have higher performance variability, or, in other words, a positive effect on variability of performance is expected from inter-country integration. Furthermore, it is expected that firms with higher levels of outsourcing have lower variability of performance as will be explained in the hypothesis development section.

This paper offers the following contributions to the literature. First, the explicit inclusion of outsourcing as one of the strategic patterns of internalization together with the more familiar geographic dispersion and cross-border integration dimensions provides a holistic framework to examine MNC performance variability. Second, the paper presents empirical support for a negative relationship between cross-border dispersion and firm variability of performance over time. Third, the paper presents empirical evidence supporting a positive relationship between cross-border integration and variability of performance. The fourth contribution of this paper is to offer empirical evidence linking MNC outsourcing with lower performance variability. Finally, the paper also offers empirical evidence suggesting that the second-order effect of combining any two of these strategic patterns of internationalization produces increased performance variability, i.e., although the first-order effect depends on the chosen strategic pattern, with the simultaneous use of more than one strategic pattern, the tradeoffs and operational complexities associated with executing and managing combination strategies will lead to a second-order effect that increases variability of performance.

2. Theoretical framework

This section develops a framework based on the multidimensional view of international strategy to anchor the examination of variability of performance. The empirical evidence examining variability of performance has been largely inconclusive because variability of performance has mostly been examined without the benefit of a multidimensional theoretical framework. As a result, this section begins by framing international strategy as a multidimensional construct and then more explicitly examines the inconclusive empirical findings regarding the effects of internationalization on variability of performance. We later develop hypotheses linking three strategic patterns of internationalization and their respective combined effects on variability of performance.

2.1. Multidimensional view of international strategy and strategic patterns of internationalization

We consider three theoretical perspectives to examine the multiple dimensions of international strategy. First, we provide the underpinnings of the traditional two-dimensional view based on local responsiveness and global integration (Doz, 1980; Prahalad and Doz, 1987). Second, we use the more recent three-dimensional framework developed by Ghemawat (2007a) to examine strategies for internationalization in a more comprehensive way. Finally, we incorporate another perspective of the international firm, predominantly from an outsourcing viewpoint (Contractor et al., 2010; Kotabe and Mudambi, 2009; Mudambi, 2008), which investigates the firm's value chain in light of its organizational and geographic dimensions.

Traditionally international strategy has been conceptualized as positioning the MNC across the dimensions of local responsiveness and global integration (Doz, 1980; Prahalad and Doz, 1987). Local responsiveness refers to an attempt by the international firm to adapt to the specific needs of host countries in which it operates. Global integration refers to the effort to coordinate operations in different jurisdictions to benefit from economies of scale or economies of scope. Several authors (Bartlett and Ghoshal, 1987; Ghoshal and Nohria, 1993; Harzing, 2000; Johnson, 1995; Martinez and Jarillo, 1991; Prahalad and Doz, 1987; Roth and Morrison, 1990) have used this integration–responsiveness framework to examine the diverse and often conflicting pressures associated with these two dimensions. In particular, they suggest that firms need to balance global integration of activities with responsiveness to local environments.

Empirical studies examining the relationship between international operations and firm performance have operationalized internationalization in several different ways, mostly using single-item measures, such as international sales as a percentage of total sales, percentage of employees abroad, and percentage of assets abroad (Annavarjula and Beldona, 2000), or as multiple items representing a single dimension (Sullivan, 1994). Focusing on one aspect of internationalization may not fully reflect the extent of the international strategic options available to an MNC, and may have contributed to the dissimilar empirical findings regarding the relationship between internationalization and performance reported in the literature.

More recently Ghemawat (2007b) expanded the multidimensional view of international strategy by proposing a three-dimensional theoretical framework of strategies for internationalization. He called these three strategies respectively adaptation, aggregation, and arbitrage — the AAA framework. Succinctly, when engaging in adaptation firms are adjusting to differences across countries by becoming more locally responsive. An implicit objective of adaptation is to reap benefits from the existence of unique local characteristics. When engaging in aggregation firms are overcoming differences across countries by taking advantage of economies of scale and scope based on similarities and complementarities. An implicit objective of aggregation is to reduce costs by combining activities into optimal units for increased efficiency. When engaging in arbitrage firms are exploiting differences across countries by seizing opportunities to create value through multi-market presence. An implicit objective of arbitrage