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The multi-faceted role of experience dealing with policy risk: The impact of intensity and diversity of experiences

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ABSTRACT

Firms learn from their previous experience, transfom routines into knowledge and thus develop capabilities. This holds for the market- and the non-market environment likewise. Experience is therefore useful to deal with policy risk arising from potential discretional and opportunistic behavior of political authorities, such as governments. We argue that firms can not only learn from the intensity of experience dealing with policy risk, but also from the exposure to a more diverse range of policy risk across different political environments. Testing a sample of 164 Spanish multinational firms, we find that the positive impact of diversity of experiences on the scope of internationalization is more important than the intensity of experience. Moreover, we also find a moderating impact between both types of experience. Overall, our findings emphasize the multi-faceted nature of experience and the need to disentangle the impact and interrelationships of its different components.

1. Introduction

Experience has long been considered a critical component of organizational learning (Zollo & Winter, 2002), an important source of competitive advantage and superior performance for multinational enterprises (MNEs) (Barkema, Bell, & Pennings, 1996). Firms are able to infer understanding from previously completed actions and respective outcomes. This helps them adjust and improve their future actions when they engage in an activity repeatedly (Levitt & March, 1988). Thus, it is not surprising that experience was also found to have a critical impact on the internationalization strategy of MNEs (Figueira-de-Lemos, Johanson, & Vahlne, 2011; Johanson & Vahlne, 1977, 2009; Lu, Liu, Wright, & Filatotchev, 2014). For instance, a firm's experience increases its likelihood of investing in institutionally more distant countries (Erramilli, 1991). Further, experience also has an impact on the choice of joint venture partners or suppliers (Inkpen & Beamish, 1997) and moderates the impact of various cultural dimensions on firms' foreign ownership modes (Cho & Padmanabhan, 2005; Slangen & Hennart, 2008).

However, experience has usually been considered as a rather unidimensional concept. Previous literature has largely neglected its multi-faceted nature and omitted potential interrelations between different types of experience (see Clarke, Tamaschke, & Liesch, 2013 for a notable exception). Only more recently studies have started to disaggregate experience into different components. In particular, scholars have provided evidence for diversity of experiences to represent a valuable source of learning and knowledge for MNEs, which they can apply to their strategic decisions on internationalization. Powell and Rhee (2013), for instance, not only examine the role of experience in a focal host country, but also the variance of experiences by players in the Japanese automotive industry. Their results show that both experience and variance of experiences, both individually and jointly, reduce the negative relationship between regulatory distance and the use of majority-owned structures for subsidiaries. In addition, Zhou and Guillén (2015) analyze diversity of foreign experience as a determinant of foreign market entry and find empirical evidence of its positive effect in a sample of Chinese listed firms. Both studies emphasize the importance of differentiating intensity from diversity of international experience.

Experience and the capabilities it helps develop in the firm have traditionally been studied within the framework of the resource and capability-based view of the firm (Barney, 1991; Wernerfelt, 1984). However, we complement this perspective with insights from two additional theories dealing with factors which affect the decision-making process of firmś managers with the aim of studying the impact of intensity and diversity of experiences dealing with policy risk.

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Specifically, we build on prospect theory and the notion of points of reference in making decisions on risk, as well as on learning theory and the notion of attention-based effects. In fact, there is abundant evidence of investments in countries with high levels of policy risk from MNEs from developed economies (such as Spanish firms in Saudi Arabia or Iran)[1] and developing ones (such as Chinese firms in Africa). Even in spite of some recent cases of expropriations or unilateral changes of agreed conditions (Jiménez, Luis-Rico, & Benito-Osorio, 2014), affected firms keep investing in risky locations in order to take advantage of their superior familiarity with this kind of environment over competitors, calling for further investigation of the different types and specific roles of experience dealing with policy risk.

As a subset of political risk (Kobrin, 1979; Robock, 1971), policy risk refers to "*the risk that a government will opportunistically alter policies to directly or indirectly expropriate a firm's profits or assets*" (Holburn & Zelner, 2010). Affecting only particular firms or industries rather than all firms in a given territory, policy risk counts among the micro-components of political risk (Alon & Herbert, 2009; Oetzel, 2005). Its definition comprises the risk of governmental discretion, i.e. the degree to which policy makers may unilaterally alter the terms and conditions governing firms and market transactions in a country (Henisz, 2000). Such opportunistic behavior can dramatically affect profitability and even be to the detriment of firm survival, for instance in case of unexpected changes in taxation, pricing or regulations of profit repatriation (Holburn, 2001). Consequently, MNEs tend to abstain from investing in countries with high levels of policy risk (Henisz, 2000; Henisz & Delios, 2001).

Yet, not all firms avoid exposure to policy risk and governmental discretion. Studies suggest that firms may seek policy risk and/or underdeveloped regulations as a source of opportunities (García-Canal & Guillén, 2008; Fernández-Méndez, García-Canal, & Guillén, 2015; Kwok & Tadesse, 2006; Oliver & Holzinger, 2008). More precisely, a firm's experience in dealing with policy risk has been highlighted as a main asset for the proactive management of policy risk (Holburn & Zelner, 2010; Jiménez et al., 2014). This experience can arise from either the firm's country of origin, or as a composite effect from all the locations where the firm is operating (Casillas, Moreno, Acedo, Gallego, & Ramos, 2009; Gaur, Kumar, & Singh, 2014).

Scholars have provided evidence for the impact of experience in dealing with policy risk on firms' internationalization (García-Canal & Guillén, 2008; Jiménez et al., 2014; Jiménez, 2010; Poisson-de Haron & Bitektine, 2015). Firms with experience in high risk countries learn how to cope with context-specific challenges by developing capabilities in risk assessment, negotiation, coalition management, information management, network development, and the like (García-Canal & Guillén, 2008; Holburn, 2001; Wan, 2005). The complex and tacit nature of these capabilities makes them difficult to imitate and may constitute the basis for sustainable international competitive advantage (Boddewyn & Brewer, 1994; Holburn & Zelner, 2010; Jiménez & Delgado, 2012).

While researchers stressed the importance of experience with policy risk per se, studies have largely used rather simple conceptualizations of experience and focused on a unidimensional, intensity-related idea of experience. Hence, we suggest employing a finer-grained conceptualization of policy risk experiences, distinguishing between intensity and diversity, to investigate the impact on firm internationalization (Clarke et al., 2013). More specifically, intensity of experience captures the experience accumulated by the average exposure to policy risk in the firms' Foreign Direct Investments (FDI), whereby FDI portfolios including more high policy risk locations imply higher intensity of experience (Powell & Rhee, 2013). Diversity of experience, on the contrary, captures the experience firms have accumulated by facing a greater variety of policy risk environments, whereby more heterogeneous policy risk levels in the locations within their FDI portfolios imply higher diversity of experiences (Harrison & Klein, 2007; Zhou & Guillén, 2015). As previously mentioned, there is an incipient but growing body of literature looking at the different effects of the various components of experience (e.g., Powell & Rhee, 2013; Zhou & Guillen, 2015). However, these studies have only focused on the experience of firms dealing with various dimensions of cross-country distance and not the experience with other relevant characteristics of the host country. To address this gap in the literature, we first hypothesize about the direct effect of intensity and diversity of experiences dealing with policy risk on the scope of internationalization. Then we discuss which effect is prevalent if both are accounted for and finally propose a moderating effect between both dimensions of experience.

Our paper contributes to the literature in various ways. First, we add to research on the role of experience in the internationalization of firms. We theorize that different types of exposure to policy risk, i.e. intensity versus diversity, generate different types of experience for the firm, which in turn have distinct effects on the MNE's scope of internationalization. Second, we qualify literature on policy risk and political capabilities by suggesting that firms learn from both the intensity and diversity of experiences in dealing with policy risk in their FDI portfolio. On top of that, we argue that these two types of experience are not independent from each other in their effect on firm internationalization, which leads us to hypothesizing a moderating effect of intensity on diversity of experiences.

The remainder of the paper is structured as follows: in the next section, we review literature focused on experience in dealing with policy risk and develop our hypotheses. Section 3 presents our sample, measures and method. Section 4 describes the results and robustness tests. Finally, Section 5 presents the discussion, conclusions and contributions, as well as limitations of our study and suggests directions for future research.

2. Conceptual development and hypotheses

2.1. *Intensity and diversity of experiences dealing with policy risk and scope of internationalization*

Policy risk stems from a lack of constraints to discretional behavior of governments and policy makers, i.e. checks and balances. It can materialize in post-investment policy changes (taxes, subsidies, local content requirements, etc.), which are to the detriment of firms (Holburn, 2001). However, policy risk can also represent a source of opportunities (Holburn & Zelner, 2010). Literature on non-market strategy and corporate political activity suggests that political resources and capabilities help firms to manage policy risk, e.g. safeguard against regulatory backslash and/or shape policy for their own benefit (Kingsley & Van den Bergh, 2015; Lawton, Doh, & Rajwani, 2014; Liedong, Ghobadian, Rajwani, & O'Regan, 2014; Mellahi, Frynas, Sun, & Siegel, 2016). Political resources and capabilities are firm-specific and can be related to human capital, organizational structure and/or network relationships (Lawton, Rajwani, & Doh, 2013). In spite of a great heterogeneity in the specific content of political capabilities, they can be denoted as "*organizational and strategic activities by which senior or acting representatives reconfigure, leverage and release political resources to achieve new resource configurations that enable the company to adapt to, anticipate or even shape changes in the corporate political environment*" (Lawton et al., 2013)).

One of the most critical political capabilities in firm internationalization in particular was found to be experience in dealing with policy risk (Delios & Henisz, 2003; Henisz & Delios, 2002; Holburn & Zelner, 2010; Jiménez et al., 2014). Experience has been recognized as an organizational learning mechanism for capability building (Zollo & Winter, 2002). By

[1] One such example is the Spanish energy multinational Repsol. After Western sanctions on Iran were lifted in 2016, foreign firms such as Repsol have been eager to enter the country although policy risk remains a concern. Prior to its interest in Iran, Repsol has gathered extensive international experience, for instance, with policy risk in Latin America.