Impact of Internationalization on Firm Performance: A Literature Review

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Abstract:

Purpose: To carry out analysis of the quantitative studies related to internationalization strategies, paths, approaches of India Inc. and its impact on financial performance.

Research Design: A thorough analysis of literature is undertaken to analyze the linkages between internationalization phenomenon and firm performance. The study has also derived insights from a variety of sources including annual reports, articles in business press, external agencies, think-tanks, industry associations, analysts’ presentations etc. The paper traces the evolution of internationalization in Indian industry, their motivations to internationalize, and the different internationalization paths chosen by them and strategies pursued to meet their organizational objectives.

Findings: The key finding of the study is that most studies validates the hypothesis that the level of exports and outward foreign direct investment (OFDI) have a positive correlation with the firm’s performance indicators such as Return on Assets (ROA) etc. Although, there are several studies which are contradictory in nature.

Research Limitations: The exploratory findings of this study covers only IT services and Pharmaceuticals, and many studies have argued that born global phenomenon is more prevalent in knowledge-intensive industries.

Key Words: International entrepreneurship, International Business, Internationalization, Born Global.

I. Introduction

According to Beamish (1990) internationalization is a process by which firms establish and conduct transactions with other countries, and as a result increase their awareness of the direct and indirect influence of international transactions on their financial future. It outlines both the economic and behavioral component of the process of internationalization (Pollard, 2001). Further, (Gibb, 1993) described it as “the change in the level of international orientation and/or activity over time.” According to Lloyd & Reason (2003) “the process of internationalization is strategic, gradual, and incremental.” It can be referred to as a “process of adaptation” as well (Calof and Beamish, 1995).

International expansion is a significant development for firms with limited access to financial resources and domestic market focus (Lu and Beamish, 2001). In the 1990’s, they didn’t have the necessary resources required for engaging in overseas activity (Kirby and Kaiser, 2003). However, globalization, technology, information revolution and modern organizational formats have enabled them to foray into overseas markets (OECD, 2005).

The traditional school of thought considered internationalization as a sequential process which is about moving in a phased manner. Typically, it starts with intermittent exports; then firms appoint agents in export markets; further they entered into knowledge agreements such as licensing or franchising and finally they invest directly into the international markets through wholly owned subsidiaries in the increasing order of management knowledge and investment (Johanson and Widersheim-Paul, 1975). However, new body of research provides empirical evidence that firms do not necessarily follow this sequential pattern (Benito’ and Welch, 1993). According to the “New Venture Internationalization Theory” propounded by Autio and Sapienza, (2000), the entrepreneurial vision and the initial resource endowment, influence early internationalization decisions. It has been found particularly true for knowledge-intensive sectors such as technology, pharmaceuticals etc. (McDougall and Oviatt, 1996).

According to Covellio and McAuley (1999) there are three schools of thought for internationalization of firms - Foreign Direct Investment (FDI), Uppsala model and Network view. The FDI school of thought pertains to neo-classical economics which suggests that firms assess benefits of expanding overseas and match them with the firms’ absorption of activities. In the Uppsala model, firms tend to expand their business operations on an incremental basis (Johansson and Vahlne, 2009) as they gain more market experience and secure top management’s orientation and commitment. The network view states that firms could foray into newer markets by building relationships with other enterprises, government, suppliers, customers etc.
The success of global firms relies heavily on their ability to cope with heterogeneous institutional, cultural and competitive environments to manage, coordinate and leverage massive resources across geographically diverse regions (Ricks, Toyne and Martinez, 1990). One of the most important capability to gain competitive advantage in global markets is the organizational design (Bartlett and Ghoshal, 1992).

The process of internationalization of a firm can be conceptualized as a set of processes by which firms’ business activities get connected to the transnational markets. The different modes of internationalization are as follows:

i) Exports
ii) Outward Foreign Direct Investment
iii) Licensing
iv) Strategic Alliances such as joint ventures, R&D collaborations etc.

These processes can be undertaken through both product and input markets (Figure-1.1)

**Figure 1.1:** Different modes of Internationalization

The product-market driven internationalization occurs when a firm decides to supply to the foreign market through exporting or through undertaking outward foreign direct investment (OFDI) to produce final products in the foreign market and/or establish trade-supporting networks to expand its overseas activities. Internationalization can also take place when firms license out their products or services to foreign firms operating in the domestic or foreign market or enter into a joint venture or engage in contract manufacturing etc. OFDI in the form of overseas acquisitions represents an alternative mode of internationalization where firm gets an easy access to foreign markets by acquiring a foreign company in the same line of business.

The input-market driven internationalization of a firm can be seen in different ways. A firm can import raw materials, inputs and capital goods or can undertake OFDI to acquire supply of raw materials from foreign market. A firm can also adopt the option of in-licensing technology contract with a foreign firm to get access to latter’s technologies and/or adopt acquisition route to obtain overseas technology and skills.
Therefore, firms have a spectrum of internationalization possibilities as represented in Figure-1.1. Which particular strategy or a combination of more than one strategies will actually be adopted depends upon firm’s resources, firm-specific capabilities and management orientation. While all the internationalization strategies are important for firms’ growth, survival and competitiveness, the present study is predominantly concerned with only two modes of product-market based internationalization - Exports and OFDI.

**Objective of the Study:**
To carry out analysis of the quantitative studies related to internationalization strategies, paths, approaches of India Inc. and its impact on financial performance.

**II. Research Methodology:**
A thorough analysis of literature is undertaken to analyze the linkages between internationalization phenomenon and firm performance. The study has also derived insights from a variety of sources including annual reports, articles in business press, external agencies, think-tanks, industry associations, analysts’ presentations etc. The paper traces the evolution of internationalization in Indian industry particularly in the pharmaceuticals and software sectors, their motivations to internationalize, and strategies pursued to meet their organizational objectives.

The computer search was made for works that related the expressions internationalization, transnationalization, Born Global or International Entrepreneurship to financial performance, results or profitability in the title of the paper. The list of references given in seminal papers were also reviewed. The theoretical papers and those based on anecdotal evidence or case studies were eliminated.

**Literature Review**
There have been numerous studies done in the field of international management on the topic of relationship between the level of internationalization and its impact on firm performance. From a positive economics point of view, the literature offers insights into both the advantages and pitfalls of increased internationalization, while from a normative point of view, it provides a roadmap for companies on how to aggressively expand their operations in international market resulting in better performance outcomes.

According to the literature review, there are studies of prominent scholars who have explained the advantages to going international, while there are also researchers who brought attention to the potential negative fallouts of doing so. The crucial question in this regard is at what levels of internationalization, do the downsides start to outweigh the benefits?

Bloodgood et. al. (1996) states that firms are required to have international operations to remain competitive in the market as it allows access to international expertise, technologies and innovations. Further, it provides firms avenues for “knowledge growth, capability development and revenue enhancement” which boost their global competitiveness. Hajela and Akbar (2013) provided empirical evidence that there is a positive linear relation between internationalization and firm performance i.e the benefits arising out of internalization far outweigh the costs incurred on it.

McDougall and Oviatt (1996) observed that firms that had higher international sales demonstrated superior financial performance. Burgel et al. (2001) deduced that firms with international operations reported higher sales and productivity growth but not employment growth, the study particularly focused on internationalization process of new technology-based sectors like the software firms.

Jones’ (1999) established the relationship between the value of cross-border activity and small firm growth. He focused on small high-technology firms and concluded that firms that are extensively networked are among the most successful in the domestic market. Moreover, they are able to create knowledge, skills, technology and resources which stimulate growth and success.

According to Burpitt and Rondinelli’s (2000) study, financial success in initial years through exporting activities motivates firms to further internationalize in subsequent periods. The partial correlation analysis in the study showed that both financial success and learning oriented variables are positively associated with the likelihood of continued exporting by small firms.

Chatterjee and Lim (2000) studied the relationship between the external factors and internal factors of firms pertaining to the degree of internationalization and impact on performance. The results supports a positive relationship exists between internationalization and performance.

Das et. al. (2015) laid emphasis on the managerial intentionality in the firm’s selection of its internationalization path, particularly in relation to firms. This study focused on two major organizational level antecedents – the firm’s exploration & exploitation orientations and slack resource. It demonstrated that these two factors have a moderating influence over intentionality to expand overseas operations.
Moini (1998) stressed upon the profitability component of internationalization, as only the greater level of profits would increase management willingness to enter export activity. Parnell (2002) outlined the conceptual and empirical challenges facing strategy researchers and suggested the inclusion of qualitative measures instead of traditional metrics such as returns on investment, return on asset, sales revenue growth, market share etc. to provide deep insights into organizational processes and resources. Overall, there is a positive association between internationalizing operations and firm performance.

In addition to export performance, it is important for firms to explore strategic options like alliances, collaborations etc. Strategic alliances permit firms to overcome many of the resource constraints to international growth (Zacharakis, 1997). In addition to the opportunities of sharing risks, alliances give access to complementary resources, such as information (Gulati, Nohria and Zaheer, 2000) and reduce the time span necessary for a broad international expansion. On the other hand, engaging in strategic alliances involves many organizational complexities and implementation difficulties (Hamel, 1991).

According to the survey conducted by Beamish and Lu (2001) the effect of alliances on profitability is positive only when the small firm chooses a local partner, i.e. a partner of the country with which the firm wants to expand geographically. Lu and Beamish(2004) concluded in their research that FDI activity initially led to decline in profitability, but later with greater levels of FDI profitability rises. They discovered that the level of exports influenced the relationship between FDI and firm performance. It was found that high exports concurrent with high FDI was less profitable as compared to lower exports with high FDI levels. Moreover, an alliance with a local partner provides valuable resources in terms of foreign market knowledge, which tends to overcome its implementation costs(Makino, Delios, 1996).

Pinho and Prange (2016) explores the relationship between social networks and dynamic internationalization capabilities (DICs), and their impact on the international performance of small and medium-sized firms in low-tech industries. The results found that social networks are a relevant antecedent of exploitative and explorative capabilities and it positively affects international performance.

According to the “three stage” theory, the effect of international expansion on firm performance is not linear. In Stage 1, international diversification cause a negative effect on performance as firms have to expend resources on learning, overcoming the “liability of origin” etc. In Stage 2, international expansion has a positive effect on performance with increasing economies of scale and scope. Finally, in Stage 3, firms overextend themselves with even higher levels of internationalization, as a result it has a negative effect on performance due to costs associated with managing the increasing complexity of foreign markets. This leads to the “S” curve of the internationalization-performance relationship, i.e. performance first comes down, then goes up and again comes down with the increase level of internationalization (Contractor, Kundu and Hsu, 2003).

Kale and Singh’s (2016) study undertook a large-scale survey of Indian DMNC’s (Developing country multinationals) who have acquired companies abroad to enter into foreign markets, acquire know-how and enhance competitiveness against global competition. It focused on how they have adopted light-handed approach to manage overseas acquisitions which ensures better post-acquisition performance.

Marano et. al. (2016) carried out a meta-analysis across 32 countries from 1972-2012 covering 359 studies on the I-P link and found out that although the relationship is positive but it’s relatively small and varies greatly across firms’ home countries. It broadly contributed to global strategy literature in three major ways – firstly it focused on how embeddedness in home country institutions affects the strength of I-P relationship; secondly it stressed upon institutional structures and complexities; thirdly it reflects on the use of advanced meta-analytical techniques to address the unresolved issues pertaining to sign and shape of I-P relationship.

### III. Analysis & Results

A total of 20 studies that analyzed the impact of the internationalization on the financial performance of the firm were identified.

The key finding of the study is that most of the studies validates the hypothesis that the level of exports and outward foreign direct investment (OFDI) have a positive correlation with the firm’s performance indicators such as Return on Assets (ROA) etc. Although, there are few studies which raised pertinent questions to the contrary. Table 1.2 outlines the studies as well as their major findings:

<table>
<thead>
<tr>
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GAP Analysis: Research Gaps and Issues

This review of literature has identified a number of issues and gaps in information that should be considered in future to enhance understanding of the internationalization and how it impacts financial performance of the firms. The appropriate methodologies and research techniques would be the subject of another discussion paper.

It has been found that while there is a good amount of research undertaken on organizational strategies and capabilities of MNC’s from developed economies, but scholarly research focusing on these aspects for emerging market firms is still rare (Hoskisson, Eden, Lau and Wright, 2000). In fact, there is a strong case for more research to be directed towards firms with origins in emerging markets as these economies have undertaken fundamental transitions towards becoming market-based economies since the 1980’s, and offer organizational researchers fascinating grounds to refine and test theories and develop new ones.

It has been observed that strategy researchers have attempted to carry out internationalization studies which involves application of learnings of the previous studies based on developed country firms. There are
many reasons given as to why the research for internationalization process & evolution of emerging markets firms must be done separately from their counterparts in developed economies:

1) A substantial amount of capital gap exists between emerging and developed markets firms (Svetlicic and Rojec, 1994).
2) The pace of institutional development and creation of robust factor markets required to undergo organizational transformation has been slow in emerging economies (Uhlenbruck, 2003).
3) The human capital in the emerging economy firms lack the knowledge, skills, foresight and experience necessary to compete in global markets (Peng and Heath, 1996).
4) There has been a sizeable change in emerging economies in terms of managerial ability, but the differences in terms of institutional infrastructures between emerging and developed economies are so immense that it prevents managers’ strategic orientation (Garten, 1996; Newman, 2000).
5) The traditional managerial capabilities that were viable and successful in planned economies are no longer effective & relevant in more market-oriented economies (McDonald, 1993; Shama, 1993), hence triggers the need for the acquisition of newer capabilities.

IV. Conclusion & Limitation of the Study:

In India, the liberalization era began with the introduction of New Industrial Policy, 1991 when territorial shores of Indian economy was opened to foreign competition, deregulation and de-licensing were pivotal themes, FDI restrictions lifted and duties were slashed to promote trade. In the 1990’s, Indian firms had not yet developed capabilities to compete in international markets, hence they began with traditional mode such as exports and gradually moved to joint ventures or floating an off-shore subsidiary. But from 2000’s onwards, with the emergence of globalization, privatization and ICT revolution, Indian firms have achieved economies of scope and scale in their overseas operations. But the firms must operate with an optimal combination of domestic and foreign operations as it’s a trade-off, it is important to deploy an effective international strategy which is in accordance with firms’ managerial and financial capabilities in order to exploit operational synergies. In order to exploit synergies, it is important to deploy such international strategy which is in consonance with organizational resources and managerial capabilities.

The leading Indian companies have undergone significant transformation towards newer forms of organizing over a decade. This transformation is seen across a range of organizational variables such as exports, outward foreign direct investment, size etc. The study also finds evidence to support the hypotheses that such organizational transformations are associated with organizational performance. In addition, the findings shed light on key strategic issues such as entry modes, competitive drivers, global networking linkages, and internationalization approaches, as well as drivers of internationalizing Indian companies. Besides tracking internationalization patterns, the cross-sectional design helped identify the dynamism and development of resources, which is a rarely explored field in the International Entrepreneurship (IE) literature.

The insights from the study suggest that overseas expansion of Indian firms is related to the need to improve global competitiveness either through acquisition of overseas assets or diversification of product offering and increasing the efficiency of existing operations. Firms employed internationalization of R&D, production and distribution strategy to develop new competencies and in parallel extend existing firm specific capabilities. The learnings and observations from this research suggest that globalization is opening up a whole set of opportunities for firms in developing countries. These firms created linkages through internationalization and the learning experience resulting from these linkages and the leverages which these linkages provide to firms has emerged as one of the main motives for internationalization of firms.

This study successfully demonstrates that internationalization and performance have a positive relationship. The findings are largely consistent with both internationalization process theory and emerging motivations of internationalization. The results are congruent with the study of Baird et al. (1994) which showed that internationalization has a positive relationship with the performance of small businesses. It shows that firms can increase their return on sales (ROS) by taking their current products into foreign markets either on their own or through foreign alliances.

Future Scope of Research

The exploratory findings of this study covers only IT services and Pharmaceuticals, and many existing studies have argued that born global phenomenon is more prevalent in knowledge-intensive industries. Perhaps, meta-analysis covering the entire India Inc. would provide greater insights about the nature of relationship between internationalization and firm performance. Further, there is a big opportunity for international management researchers to investigate the phenomenon of internationalization in the context of emerging
market firms and suggest the path forward to them as the major economies are increasingly becoming more protectionist in their approach.

References