

Research Article

A Study on the International Diversification Motives of Multinational Corporations

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Abstract: The study tends to discover what drive Multinational Corporations (MNCs) to expand its international markets. Drawing on previous research and extant theories, this study will propose some conspicuous motives-top management team, host country endowment and firm-unique resource. The study discovers that top management team such as top executives, managers, boards of directors and owners have significantly influence MNCs to expand its business across border. Reviewing a wide range of literature in management and related fields, it is indicated that host country endowment has played a crucial role in spurring MNCs to go overseas markets. Another important actor encouraging MNCs to diversify its markets beyond borders is its ownership advantage of unique resource. A theoretical model, triangle-motive of international diversification, is developed to advance that the above mentioned motives do influence MNCs to internationally diversify its operating activities.

Keywords: International diversification, Internationalization, Resource-based view, Upper echelon

INTRODUCTION

One of the most significant challenges larger firms face is to establish its international markets, principally during the growth stage. Conspicuously, previous empirical work had proposed that there exist potential threats underlying internationalization (Tihanyi *et al.*, 2000). However, many scholars and researchers of internationalization have been particularly interested in discovering considerable advantages resulted from international diversification (Martin *et al.*, 1998; Nachum and Zaheer, 2005; Ricart *et al.*, 2004; Hitt *et al.*, 2006; Contractor *et al.*, 2007; Lu and Beamish, 2004). Different domain of international operations, namely strategic choice of ownership, strategic entry mode, local and international competitiveness, strategic alliance, cultural diversity and organizational consequence, have been attentively examined.

Notwithstanding a wider range of these work acknowledge the significance of corporate executives (Hambrick *et al.*, 1996; Rugman and Verbeke, 2001), external environment imposed by host country which might affect the organizational performance and link between MNCs' international expansion strategies and their performance outcomes (Martin *et al.*, 1998; Gomes and Ramaswamy, 1999; Hitt *et al.*, 2006) in the internationalization process, relatively few research have focused specifically on the significant motives such as the role of management team, host and home country endowment, ownership of unique resources driving MNCs to internationally diversify its operations.

A noticeably mounting research effort in management literature is devoted to better gaining a deep insight of the role strategically played by the top management teams in driving MNCs to do business beyond borders. The paper documented here aims to extend this domain of research by emphasizing on the link between the characteristics of top management teams, as a motive and MNCs' international diversification.

Exploring what exactly drive firms to consider doing business across border is important for scholars of international business. Nachum and Zaheer (2005) insert that "understanding why firms go overseas is critical because the rationale for foreign investment largely underlies the very nature of MNEs and their behavior." Erstwhile studies observed the primary link between structure of organization and size with an increase in international involving activities showed that this relationship is certainly embodied in international diversification (Hitt *et al.*, 2006).

This study has three main aims to be achieved. The first is to review work of literature that has addressed the upper-echelons view, location-based view and resource-based view. The second is to propose a model of how upper-echelons natures, favorable resource endowment embedded in host country and firms' unique resource advantage might become reflected in MNCs' international diversification. The final aim is to provide a fundamental base and impetus for empirical research into the relationship between managerial background, host country endowment, firm-specific capabilities and

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MNCs' international diversification. To meet the final aim, the study identifies some major variables, propositions and methodological suggestion.

LITERATURE REVIEW

International diversification: Top executives often take into account of diversification of corporate activities beyond national border as a multifarious strategic decision. Since they are among the most influential people of a firm, they are supposed to deal with such complexity involved in the geographical diversification decision which is partly induced by the increased local and international challenges-opportunities and threads-they face in international markets. Many research suggested that there is a need for the amalgamation and organization among top management teams which might influence a positive economic outcomes and thus play important role as strategic decision makers steering the firm towards overseas market (Michel and Hambrick, 1992).

A broad range of research advances that international diversification offers MNCs substantial advantages. "Advantages associated with international diversification are underscored by studies on foreign direct investment, international product life cycle model, oligopolistic competition and the MNCs' operationalization" (Tihanyi *et al.*, 2000). Contractor *et al.* (2007) and colleagues argued that benefits from international expansion derive from proprietary and firm-specific asset. An empirical study indicates that international diversification might offer firms with competitive benefits (e.g., global economies of scale, access to resource endowment or technologies) which may be improved in the domestic market (Gimeno *et al.*, 2005).

By internationalizing, MNCs may enjoy economy of scales (Gomes and Ramaswamy, 1999) and increase maximized profits by spreading fixed costs over a bigger market; gain better and easier flexibility and accessibility to resource endowment in the host country-cheaper labor, more advanced technology, or any other specific-country resources; and be potentially exposed to multifaceted stimuli that offer a wider range of new learning environment opportunity to continuously improve its varied competencies more than are their straight domestic counterparts (Lu and Beamish, 2004).

Another stream of study mainly conducted to find out what challenge MNCs face when having its subsidiaries in foreign countries. Lu and Beamish (2004) argued that MNCs may face specific challenges when establishing its new subsidiaries in a new foreign market. They claimed that any new establishment would incur higher costs concerning liability of foreignness because it may not transact its business activities as effectively as a domestic firm. Although international expansion signals a remarkable performance growth of

MNCs, lack of information about foreign market creates uncertainty and that MNCs would suffer higher costs. Martin *et al.* (1998) argued that there existed underlying uncertainty when expanding into a new market and thus firms must be sensitive to information constraint.

Despite findings concerning both advantages and disadvantages resulted from the application of international diversification, what influences such decision is more critical. Since the international diversification decisions might influence MNCs' performance out-comes, it can be of greater interest to top management people. Investigation of the decision-making process within MNCs has contributed considerably to an insight of internationalization decisions (Tihanyi *et al.*, 2000).

Top management team: Extensive research of international business and management has examined several observable characteristics of top management people as firms' internationalization influencers. Hambrick *et al.* (1996) named such characteristics "age, tenure in the organization, functional background, education, socioeconomic roots and financial position". From the heart of upper-echelon theory, they posited that such observable features can be used as fundamental tools for cognitive base which leads top management teams to decision making. Thus, it is obvious that top management people are of those influential decision makers who are capable of steering MNCs across border and supposed to deal with risks in international market (Hitt *et al.*, 2006).

To better gain a bigger picture of how top management people such as chief executive officers, managers and board of directors contend with ambiguities in international markets, some recent studies have examined the characteristics of top management teams (Hitt *et al.*, 2006; Tihanyi *et al.*, 2000; Hambrick *et al.*, 1996; Hambrick and Mason, 1984). Although these studies emphasized on top management teams in distinct roles, there appears to be a single consensus to embrace that, through their decisions, the features of these decision-making teams might positively influence a firm's success (Tihanyi *et al.*, 2000).

Demographic characteristics of top management teams are condensed into five variables which are believed to have significantly influences on MNCs' inter-national diversification. These variables: age, education, functional background, international experience and tenure on the top management teams (Tihanyi *et al.*, 2000; Hitt *et al.*, 2006).

Average age: Erstwhile research has shown that young-age managers are more likely to bring consider-able change to firms' strategy, whereas older-age managers are less likely to adjust themselves to novel ideas or unwilling to accept new behaviors (Tihanyi *et al.*, 2000). Moreover, older managers might be at a stage of their

lives where financial security is vital and adventure-oriented behaviors appear to be threatening to their career security. Lastly, older managers might bear a lot of risk underpinning status quo, as it reflects upon the strategies they used over the years (Hambrick *et al.*, 1996).

The complicated phenomenon and risk involved in international diversification might confront top executives, especially the young, active and dynamic ones who are more likely to assume the risk related to inter-national expansion in exchange for the potential reward and career development (Tihanyi *et al.*, 2000). As Hambrick and Mason wrote, younger executives seem to have more propensities toward “attempting novel, the unprecedented, taking risks” (1984: 198). Thus, it should be proposed that:

P1: MNCs with younger-age managers will have greater propensities to pursue risky strategies regarding international diversification than will MNCs with the older ones.

P2: MNCs will enjoy substantial growth and variability in profitability from industry averages whereas the older ones will do less.

Elite education. Formal educational offers a vital aspect which may help mold a person’s cognitive base (Hambrick *et al.*, 1996). Recent study has advanced that there is a distinctive set of influence with an elite education. More important concept goes to the heart of the study that elite educational institutions give their students more than simply just a formal education (Tihanyi *et al.*, 2000). The core of the study also indicated that students participating in such institutions are ex-posed to targeted vocabulary, dressing styles, esthetic touch, values and beliefs-encouraging students to have a more open-minded toward other cultures. In addition, elite education can provide students with experience of international learning environment and chances to meet other elites from different international backgrounds. Thus, it is suggested that:

P3: There will be a positive relationship between elite educations of top management teams and the degree of MNCs’ international diversification.

International experience. Work experience is thought to have a greater influence on some sorts of behavior shaped by an executive or a whole top management groups (Hambrick *et al.*, 1996). Managers recruited from the outside are more inclined to bring changes in structure, working processes, people arrangement than are the internal managers promoted from within. More recent study discovered that top management teams with international experience seem to be a crucial motive of international diversification for several reasons. An international experience may first cut down the uncertainty involved with international

expansion and second develop social capital which may smooth a firm’s intention to internationally diversify (Tihanyi *et al.*, 2000). Third, international experience in the top management teams is likely to mount up the internationalization speed, especially in small firms (Hitt *et al.*, 2006). Thus, it leads to a proposition that:

P4: International experience of top management teams will hold a positive link with the degree of MNCs’ international diversification.

Top management teams tenure. Tenure lies within the team is a vital factor of the team growth. Growing tenure involved in stability, eliminated conflict, smooth communication (Tihanyi *et al.*, 2000). Moreover, greater length of tenure on the top management teams might have a relationship with social cohesion and shared cognitive bases (Michel and Hambrick, 1992). Although, there might be some degree of uncertainty and complex nature of international diversification decisions (Gimeno *et al.*, 2005), a shared insight of inter-national atmosphere among the teams might be critical. Having come across longer tenure on top management teams, executives might create more correct shared knowledge bases concerning new international climate. Thus, the present writer proposes that:

P5: Higher average of the top management team tenure will be positively associated with the degree of MNCs’ international diversification.

Functional background. In addition to educational background, working experience in particular functional areas has a significant effect on the shape of a manager’s knowledge bases (Tihanyi *et al.*, 2000). As Hambrick and Mason noted, “...functional-track orientation may not dominate the strategic choices an executive makes, but it can be expected to exert some influence” (1984: 199). Functional background has greater effect on top executives’ critical thinking and decision making skills. Thus, such a wider functional background will enable top management teams to better cope with environmental complications (Tihanyi *et al.*, 2000). Therefore, these reasons lead to a proposition that:

P6: There will be a positive relationship between functional background of top management teams and MNCs’ international diversification.

Figure 1 depicts five demographic variables contributed to the top management team development which leads to influence MNCs’ international diversification.

Host country endowment: A motive behind MNCs’ international diversification can be found by the richness of resources existed in the host country. Researches have been conducted to uncover the influences that intangible resources in a host country have on firms’ strategic decision (Hitt *et al.*, 2006). The results posit

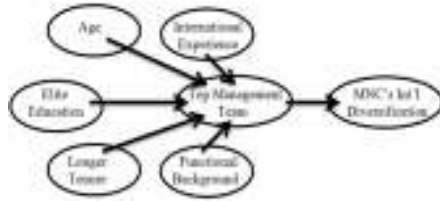


Fig. 1: Upper-echelon theory



Fig. 2: The 'ARK' theory of location-based advantage

that “firms with higher endowments of intangible resources are more likely to expand internationally” (Hitt *et al.*, 2006).

Geographical proximity in the host country has become imperative when considering international expansion due to the fact that any decision to relocate specific operations across national border is potentially significant to MNCs' success. They indicate that the economy of a host country might be shaped by the sheer of activities, re-sources and knowledge bases so that firms are able to effectively exploit these resources. A knowledge-based view of locations proposes that there exist knowledge bases which may be only seen elsewhere but intertwined with a specific area. Therefore, the three perspectives (ARK) seem to back up the argument that the host country endowment comes to playing a crucial role in driving MNCs to diversify internationally. Thus, it is proposed that:

P7: There will be a positive pair between the host country endowment and MNCs' international diversification (Fig. 2).

Firms' unique Resource: Many theories have been put forward and put into practices because of its positive influences perceived by many MNCs all over the world. One theory which may present its most powerful impact on MNCs is Re-sourced-Based View (RBV). Drawing from an extensive research and relevant literature review of management, strategic management and other theories, it was revealed that the RBV of firms' competitive advantage is one of the single most important strategic management theories appropriate to justify the performance of an organization and partly originated from management theory group that has been developed to fit the needs of managing the organization

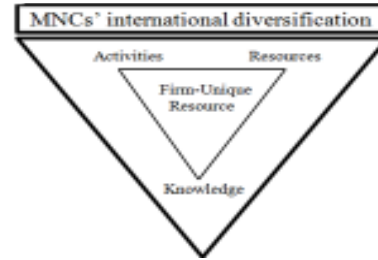


Fig. 3: The 'ARK' theory of Firm-unique resource

in a diverse business environment effectively (Raduan *et al.*, 2009).

Another line of study of over 1,500 manufacturing firms in some European countries specifically Spain, Germany, the United Kingdom, France and Denmark shows that nations' institutional aspects (i.e., capital markets, financial intermediaries and skilled labors) have a great influence on both internal and external competitive advantage of firms (Bobillo *et al.*, 2010). Bobillo *et al.* (2010) and colleagues note that “the success of internationalization is dependent on the exploitation of these firm-specific assets (e.g. organizational advantage, technological knowledge and reputation)”.

According to the resource-based view, heterogeneity of firms in possessing and conquering unique resources is a main driver of sustainable competitive advantage and thus influence firm's performance (Chen and Hsu, 2010). Drawing the strategy literature, there are three views that have discovered the originality of advantage. First, the activity-based view, suggests that how firms efficiently and effectively perform their activities will influence its performance outcome. Second, the resource-based view advances that earnings generated from rents or leases of its unique stock of resources will have a great influence on its performance. Third, the knowledge-based view posits that performance of firms will be shaped by the ability of the firms to create and exploit its firm-specific knowledge (Ricart *et al.*, 2004; Bobillo *et al.*, 2010).

Drawing from the firm-based advantage (Ricart *et al.*, 2004), other theories and literatures, firm-specific advantage existing in firms' activities, resources and knowledge should be one the most important drivers of firms' international diversification, which can be empirically tested. Thus, a proposition can be drawn that:

P 8: There will be a positive link between firm-specific advantage-activities, resources and knowledge and MNCs' international diversification (Fig. 3).

THEORETICAL MODEL

The following section illustrates a theoretical model constructed from the three proposed motives-top management team, host country endowment and firm-unique resource-that play a fundamental role in driving

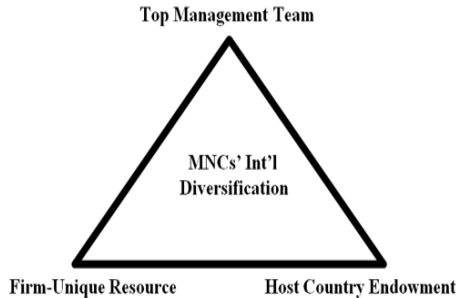


Fig. 4: Triangle-motive model of MNCs' Int'l diversification

MNCs' international diversification. Figure 4 depicts a triangle-motive model of International diversification which can be arguably said to be significant antecedents of MNCs' internationalization process.

The model represents the relationship between the motives and the international diversification decision of MNCs. Top management team profile-age, elite education, international experience, longer tenure and functional background-is very critical for a firm's performance. Tihanyi *et al.* (2000) agreed and acknowledged that there exists a positive relationship between certain features of top management teams with firm's international diversification. Drawing on the upper-echelon theory, Hambrick *et al.* (1996) advanced that certain organizational effectiveness is highly connected with top management team having particular demographic background (i.e., younger-age, more international experienced with multifunctional track, longer tenure, with elite education) which ultimately constitute certain behaviors, firm's strategies and performance outcomes. Thus, it leads to a proposition that characteristics of top management team will strongly be a motive which drives MNCs to diversify international in a higher degree of internationalization.

Another angle of the triangle-motive model, host country endowment, is an equally important driver of international diversification of MNCs. Location-based theory suggests three synergic views-activities, resources and knowledge-which influence MNCs to expand its operations in foreign markets (Ricart *et al.*, 2004). The study indicated that firms also seek knowledge embedded in the host country. Such an attempt is induced by the desire to exploit diverse resources aimed at improving their own competencies. Nachum and Zaheer (2005) found that high information intensive firms are highly motivated by a tendency to explore new knowledge in the host country.

The last angle of the model, firm-unique resource, seems to have played significant role in building sustained competitive advantage for MNCs and thus is positively associated with international diversification of MNCs. Resource-Based View (RVB) posits that, in the field of strategic management, the fundamental as-sets and influencers of firms' competitive advantage and

optimal performance are primarily connected with the features of their unique resources and capabilities which are priceless, costly to imitate and hard to substitute (Raduan *et al.*, 2009). In an attempt to satisfy the main aim of this study, a broader range of research and literature review from multiple theories have been examined in order to pro-pose the three edges of the triangle-motive model of MNCs' international diversification. Since a decision of a firm's internationalization is dependent on the three factors, it is plausible that top management team, host country endowment and firm-unique resource are treated as independent variables, which may lead to the international diversification of MNCs.

CONCLUSION

In this study, we aim to examine the main motives behind the international diversification of MNCs. The starting point was derived from a curiosity of what exactly drive firms to expand its business activities in foreign market and thus there is no other way but to review an extensive existing literature. From an inference, it should be believed that people are the first most genius species on earth who have been shaping a world today. Second, it is generalizable that every single country never has enough resources which could satisfy the need and demand of mankind and thus should discover through international trade. Third, from a reason-able thought, a firm must have unique assets if wanting to proper in the long run.

Major contributions of the upper-echelon and agency view have been particularly critical for firm's internationalization. A proposition that top management team, the main driver of MNCs' international diversification, should be possibly empirically tested. Both theories suggest that characteristics of top management team (i.e., age, elite education, international experience, longer tenure and functional background) may have a greater influence on a firm's performance since they are the key important decision makers (Hambrick *et al.*, 1996; Tihanyi *et al.*, 2000).

This study opens up several avenues for future direction regarding the influence of TMT on international diversification. Although prior and recent studies have emphasized the important linkages between TMT characteristics and MNCs' internationalization, both scholars and researchers should extend this area in several directions. Researchers may wish to investigate the influence of TMT on international involvement through a more empirical analysis and thus should focus on more specific features of the top executives such as their country of origin and specific international functional experience to identify how such international exposure affects top managers' decision-making. Finally, al-though most studies have examined the demographic variables of TMT, future researchers

should employ some scientific methods such as surveys in order to gain a better insight of the internationalization decisions.

Locational proximity has been discovered to be the most convenient platform to begin the initial international expansion. Firms are more likely to internationalize in a country which share similar commodities, culture and near to their country of origin. This motivation may lay on the fact that firms might enjoy low transportation cost, smooth communication and trade policies such as import tariff imposed by the government of the host country. Therefore, this leads to a proposition that the host country endowment will have a positive association with MNCs' international diversification.

Firm-unique resource is found to be a major active driving force to create competitive advantage for firms. The success of internationalization is heavily relied on a full utilization of the firm's unique resources such as organizational advantage, technological knowledge and reputation (Bobillo *et al.*, 2010).

Future research direction in the area of firm-unique resource should be to examine closely the subsidiary-specific advantage which may lead to a new challenge and rewarding for expatriate managers of the firm's subsidiary. Since MNCs exist because their capabilities to promote the application of transferring and exploiting resource and knowledge are more effectively and efficiently within the firm, managers would be more rewarded. Thus, the future researchers should take into account the knowledge transfer which may help build sustained specific-subsi-dary advantage and facilitate the smoothness of the flow of operating activities in the subsidiary.

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