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21. Strategic expansion decisions and cultural differences

Abstract

This paper compiles a set of research findings regarding a firm's decision to expand abroad. When creating an organizational presence in foreign cultures, firms are confronted with different and ill-understood cultures. Learning to deal with such cultures defines their success in establishing a long term presence in different cultures. The learning is stepwise and sigmoid, and often involves double layered acculturation: becoming familiar with different organizational, and national cultures.

Introduction

In this paper we will report on a number of studies that deal with organizations venturing abroad. Many firms are going through a process from being a domestic institution to becoming a global player. The internationalization of their operations confronts them with new uncertainties and allows us to explore how they cope with alien markets. The study of foreign entry is truly germane to the issue of 'decision-making under different economic and political conditions.'

In the following paragraphs we will review some recent findings on the success and failure of firms that have expanded beyond their national borders. These findings are timely since national borders become decreasingly critical in the behavior of organizations. The world is evolving toward cultural blocks in which individual countries become secondary entities. Furthermore, the cultural blocks become intertwined. This is most apparent in the three important blocks, Pacific Rim, North America and Western Europe. Firms navigate within and across these blocks and face various political and cultural barriers.

The questions we asked included the following. What sorts of cultural barriers do firms encounter when they expand beyond national borders? If organizations obtain a foothold in a foreign country, or different cultural block, do they reduce these barriers? Do firms manifest certain path dependencies when they make such expansions, and learn therefore in distinct ways? We relied on the concept of *organizational learning* to define the research design and generate hypotheses. When organization venture into new domains they should have a basis from which to do so – whether this venturing involves the development of new products, the creation of a new organizations firm in a distant land, or the partnering with firms that operate in other markets or other cultures. When we invoke the term learning, reference is being made to firms building up knowledge, experience; this knowledge becomes a platform for innovations, further foreign expansions, and so on. Whether they undertake innovation, diversification, or globalization, firms encounter different conditions that challenge their capacity to implement decisions. Past decision heuristics can be molded to craft new ones. However new, we also imply that the crafting of new heuristics evolves incrementally (compare Nelson and Winter, 1982).

We believe such research to be of great importance in view of the fact that many firms are spanning operations in many different cultures. While political structures and their politicking continue to be parochial and ethnocentric, we see that business firms display a great deal of audacity in venturing abroad. Even small and medium sized firms extend their operations toward other countries. They encounter conditions that tax their decision-making ability considerably. How do they fare? This paper reports on some studies involving Dutch firms that show encouraging results; encouraging because if firms allow themselves to learn they become increasingly successful in overcoming cultural barriers. The results were based on a Dutch sample of firms. Because of their limited market potential, Dutch firms have always sought commercial opportunities elsewhere – they had little choice. However, the issues are also relevant for seemingly autarkic countries who were blinded by the illusion that they would not need to venture abroad. Multinational becomes an adjective that is applicable to a wide variety of organizations in almost any country of the world.

Background

Organizations are prone to expand the limits of their current operations, but do so with the typical limitations that involve collective decision-making (e.g., Cyert and March, 1963). They explore new technologies, products and markets. In the course of their existence, they build up competencies which provide a platform for new initiatives. In short organizations learn. They do so incrementally, step by step, so that it often seems that they stay in the vicinity of their current repertoire of activities (March and Simon, 1958). March (1988) and Nelson and Winter (1982) are currently among the key contributors on organizational learning. They show that organizations are constantly responding to their past actions, although the former tends to infuse a greater degree of haphazardness and non-linearity than the latter. Both March and Nelson and Winter would agree that when firms cope with uncertainty, they build up experiences that endow managers with the capacity to more successfully implement new efforts.

There is already a vast amount of literature on firms diversifying abroad (e.g., Dunning, 1988). Numerous studies exist on strategic alliances across borders, mergers and acquisitions among firms belonging to different countries and different blocks, and other forms of foreign direct investments. In fact one might distinguish between different forms of ownership and different modes of entry. For example, some firms prefer to expand alone rather than with partners; also some are inclined to create a wholly owned subsidiary while others make outright acquisitions of existing organizations. For example, after the collapse of the Soviet block, some firms have obtained Eastern German firms through the Treuhandvorstand, while others have started de novo. In Russia and Ukraine, many firms have formed joint ventures with local firms, perhaps because they prefer to spread the risk, or because they believe such partnering to ease the difficulties of making decisions in environments that are different from their own.

Learning

There is not so much literature on whether firms succeed when they venture abroad. It is one thing to know where and to what extent a firm expands into strange or distant countries, it is quite something else to know how successful they are. It is at this junction that we can invoke the terms strategic learning and restructuring.

Learning exists at both the individual and collective level, although collective learning is much more difficult to conceptualize and to measure. A significant contribution was made by Nelson and Winter (1982) who argued that firms are repositories of routines which they have accumulated in the course of their history. Firms continue to add routines to their current repertoire of routines. Routines resemble scripts, or psychological blueprints for behavior. Experimentation typically takes place in the vicinity of existing routines.

When firms enter foreign countries they may be short on appropriate routines until they have become familiar with the host country. There is ample evidence that national culture represents tacit knowledge; it cannot be readily codified or articulated. Transfer of tacit knowledge is much more problematic than the acquisition of explicit knowledge. This might also be the reason for national borders to be less permeable than organizational ones (Kogut, 1988). At any rate, organizations move along a learning curve when they venture abroad. They need to build career paths, personnel linkages, task forces to facilitate the flow of knowledge from the home country to the host country.

Eventually, organizations may accelerate their learning progression since learning typically displays a sigmoid pattern in which learning advances initially slowly, until there is a ramp-up, followed by an asymptotic stage where little new learning takes place. Learning, however, does not only unfold geographically, but also within a certain time frame. It is important to recognize that learning takes time, and that time compression is usually not feasible (in spite what some policy makers or parents may wish when they seek to speed up the developmental process of their constituencies and children respectively; compare Dierickx and Cool, 1989). Each country, however, is not equally different from any other country; in fact transfer of knowledge from one country to another is likely to be much easier when countries belong to the same *cultural block* (compare Ronen and Shenkar, 1986). Countries that are closer to home are more likely to involve lower cultural barriers, because their culture is more similar to that of the firm's home country. Yet geographic proximity does not coincide neatly with cultural similarity; compare the US and Cuba, or Italy and Switzerland. Firms will face fewer hurdles, it seems, if they venture firsts in culturally proximate countries, followed by culturally proximate blocks, before they venture toward culturally distant blocks. All this assumes a minimum amount of time before such a sequence of steps can be implemented.

Firms enter foreign cultures either alone or with partners

In fact, they often seek out host country partners to ease entry. We can distinguish between acquisitions and joint ventures. Acquisitions require an expanding firm to identify an existing firm whose resources (financial, human and social capital) can speed up the expansion into foreign countries. Joint ventures can take on numerous forms, including varying ownership arrangements, co-manufacturing, research and other cooperative agreements, and licensing agreements. In the case of joint ventures, the expansion into a foreign country might involve a new firm (also called 'green field') or an existing firm. What sets such expansions apart from wholly owned foreign subsidiaries is a process of 'double layered acculturation.' When the firm expands through other organization, it has to learn both the foreign culture, as well as an alien organizational culture. Paradoxically, firms which find it easier to expand with others face therefore more hurdles when they do so abroad.

Restructuring

Restructuring is related to learning in that the term conveys the undoing of acquisitions, joint ventures or the building up of new ventures. In other words, the liquidation of expansion projects amounts to a form of negative feedback. True, the term has obtained a rather general meaning, to include any reduction or retrenchment. The elimination of authority levels, the dismantling of a division, the massive dismissal of employees all are presumed to be covered by the term restructuring. Nevertheless, dissolution of foreign expansions is perhaps the best example of a firm that ventured abroad, and failed to succeed. Consider Renault retreating from the US, RSV, a Dutch shipbuilding firm from Algeria, or Royal Dutch from aluminum mining in Surinam. All these retreats represent failed foreign expansion projects. Because sunk-costs are often extensive and render firms entrapped in their commitments, they often postpone a response to negative feedback – witness for example the Disney Corporation whose Parisian investment appeared to involve a cultural barrier too high.

Even vertical expansions do not always fare well, in spite of Williamson's advocacy to the contrary. Vertical expansions are illustrated by breweries opening their own bars and cafes, chemical firms setting up their own transportation unit, or accounting firms doing their own data processing system. Numerous firms are currently going through a process of outsourcing in which they liquidate such operations and contract for independent firms to carry out for them. The outsourcing is not limited to trivial and strategically peripheral activities like catering and cleaning. More critical operations are also becoming outsourced (e.g., Garybadze, 1994). Compare computer firms such as Hewlett Packard and Apple Computer which move software development to engineering firms in Bangalore, India and Uzbekistan. Many of the retreats from formerly proprietary operations imply some acknowledgment that outside firms can perform these activities more efficiently and effectively. Because firms are often victims of entrapment in previously made commitments, they often postpone a response to negative feedback.. Presently, the most dramatic illustration is the dire, but prolonged state of Eurodisney where the parent fails to appreciate that its Parisian investment involved a cultural barrier too high.

Examining corporate success and failure of foreign expansion projects confers an ideal opportunity for producing insights about decision-making in divergent cultural context. We have been involved in a number of empirical investigations to isolate the factors which account for expansion failures in relation to cultural barriers (Pennings, Barkema and Douma, 1994; Barkema, Bell and Pennings, 1995).

We assumed that firms continuously build platforms for further expansion. We set out to propose a pattern of incrementalism: firm build up foreign expansion skills by firsts venturing close to home, before investing in other countries that are in proximate blocks, and only then entering more remote cultures. This pattern is graphically depicted in Figure 1.

Figure 1 shows in the *top part* that a firm's ability to deal with foreign cultures follows a stepwise experience curve. Any new presence in a different culture is conditional on having accumulated experience in a host country, in the host country's cultural block, and so on. The *bottom part* of Figure 1 shows a sequence of experience curves (which have typically the sigmoid learning curve shape) that corresponds with an expanding firm's increased cultural

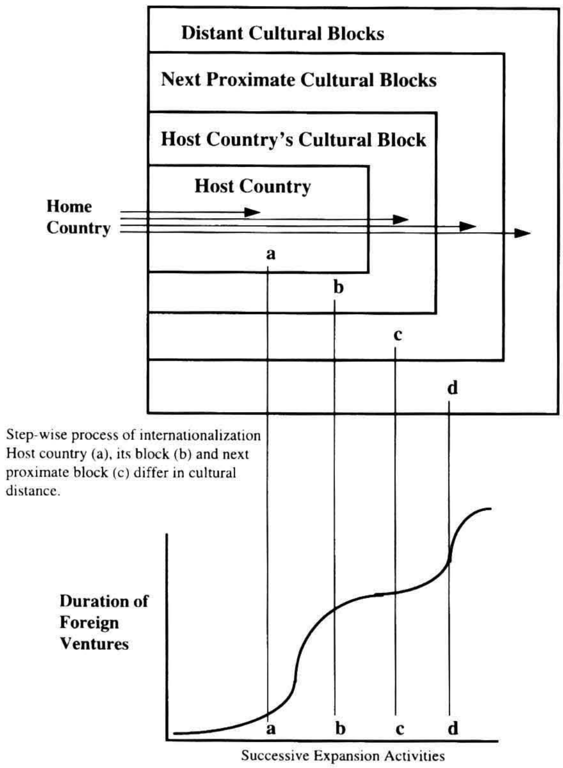

Fig. 1. Foreign Expansion and Learning

distance. More specifically we tested the following hypotheses:

1. Durability of foreign ventures is negatively related to the cultural distance between the home country and host country.

2. Duration of foreign expansion is contingent upon cultural distance and involvement of foreign partners; other things being equal , duration will be shorter if cultural distance is large and foreign ventures involve existing firms or strategic partners. However, prior experiences with existing firms in foreign cultures will improve the odds of expansions

Empirical findings

The implication of these hypotheses are self evident. Experiences in foreign environments will reduce the height of cultural barriers, especially when such experiences are accompanied with inter-organizational experiences.

Cultural barriers can be inferred from a variety of data. We decided to follow a two-pronged approach. in order to model the significance of cultural distance and foreign expansion. The cultural distance between the host country and the home country (= The Netherlands) was calculated by means of an Euclidean distance index (compare Kogut and Singh, 1988). The index is based on the four cultural dimensions in the large scale study of Hofstede (1980). We calculated the cultural distance from the Netherlands to the host country as follows:

$$CD_j = \sum_{i=1}^{4}(I_{ij} - I_{in}^{2})/V_i/4$$

where:

CD_j=cultural distance of the jth country from the Netherlands;

i = cultural dimensions, respectively:
* Power Distance Index
* Uncertainty Avoidance Index
* Individualism
* Masculinity

I_{ij} = index for the ith cultural dimension in country j (= host country);

I_{in} = index for the ith cultural dimension in the Netherlands;

V_i = the variance of the index of the ith dimension.

Scores on the four dimensions for the countries in our study were obtained from Hofstede (1980). For some countries in our data set, these scores were not available from Hofstede's study. These scores were determined in personal communication with Hofstede.

Furthermore, dummy variables for each cultural block, using Ronen and Shenkar's (1985) classification and complemented with personal communication from Hofstede, were employed as a second proxy for cultural distance. Negative effects associated with these block dummies are expected, with their order of magnitude conditional on the block's cultural distance relative to the Nordic block (that also contains the Netherlands). While cruder than the Euclidean distance index, it does not implicitly assume the linearity, additivity, and normal distribution of scores on the variables.

The research covered the period 1966–1988 and involved 220 expansion projects of 13 Dutch multi-national enterprises (MNES). MNES are organizations that have made investments in more than one country; other terms that are frequently used are multi-domestic and transnational. Since we were interested in the duration of these projects we employed an event history analysis, with maximum likelihood estimation as this allows us to model the survival of projects over time. Dissolution of an expansion project signal failure or restructuring and is more likely if the firm lacks experience with unfamiliar cultures. Learning cultivates familiarity and is indicated by prior presence in a proximate country, or its cultural block. Learning is further assumed to follow incremental patterns with the firm firsts building up familiarity close to home, before it generalizes its skills to more distant cultures, and with other firms. In the regression analysis we included therefore indicators of both 'location learning' and ' inter-organizational', where learning amounts to the number of prior expansion experiences.

The earlier paper (Pennings, Barkema and Douma, 1994) had shown that the interaction between two variables was highly significant.

They involved the variable 'domestic-foreign' and 'start-up-acquisition.' The learning effects were best discernable if foreign ventures are a joint effort, or draws from existing organization. In the second study (Barkema, Bell and Pennings, 1995) the analysis was focused much more explicitly on a firm's foreign venturing. The results were essentially in accord with the above theory. An expansion's longevity is highest whenever it is undertaken in a culturally similar country, proximate block, or in a more distant cultural block, provided the firm has prior globalization experiences there. Overcoming cultural barriers is most prevalent whenever expansion involves partners. This latter finding surfaced when we performed a sub-category analysis involving foreign ventures with shared ownership, or foreign ventures that involved the acquisition of existing foreign firms.

Finally, a rather interesting finding involved *double layered acculturation*. Recall that we argued expansion with partners in foreign cultures to require the firm to contend with two levels of culture: country and organization. The results showed that those firms which expanded abroad with or through other firms to greatly improve the chances of subsequent success.

A firm that makes increasingly more distant investments in other cultures follows a stepwise, but smooth process. The skills it accumulates in nearby cultures can be leveraged when proceeding to more distant cultures, first the same cultural block and then to other, proximate blocks. the success of moving activities in even more distant blocks is conditional upon having gone through these intermediate steps. The top of the Figure signals the stepwise expansion, while the bottom graph shows a conventional learning curve. Learning curves have an S-shaped form, beginning with a slow increment, a 'ramp-u' to an a-symptotic level, where additional learning shows diminishing returns, until a new learning process starts – in this case in more distant cultural settings. In the above studies, the feedback from foreign initiatives consists of expansion projects that fail or succeed, with the presumption that success breeds success.

Discussion

Firms are increasingly entering global markets, seeking cost advantages, for example through lower labor costs in foreign countries, and following the demand for their products. The results in our series of studies showed that firms entering the global game of foreign direct investment face cultural adjustment costs, especially when they engage in double layered acculturation, such as in case of acquisitions and majority and 50/50 JVs, but can also move along a learning curve in case of such ventures. Especially when they choose their expansion path such that they can exploit previous experience in the same country, in other countries in the same cultural block, and in culturally more proximate blocks. This also suggests that firms or countries having unique product or cost advantages, such as a firm having a product that is unique abroad and may allow monopoly gains, or a foreign country having a cost advantage such as a skilled labor force at a low price (Eastern Europe, India) can profitably exploit such advantages, especially if they proceed along a centrifugal learning curve. The present study contains some clues about how they could proceed.

The study of decision-making under different economic and cultural conditions is becoming increasingly important. Even small firms are becoming organizations without citizenship. Venturing away from home environments entails a good deal of uncertainty . Our research has shown that firms can be successful in dealing with strange environments, provided they travel along a learning curve, gradually and incrementally venturing farther away from their home country.

The limitations of these types of studies however, should be recognized. Transfer of knowledge from the foreign culture involves individuals. Firms posses a certain amount of human and social capital (Burt, 1992), and it is particularly the social capital that is crucial for enhancing a firm's stock of decision-making routines in alien cultures. Social capital represents the networks which firms develop within and across their boundaries. They might encourage individuals to develop contacts with employees elsewhere, but also with customers, suppliers and other firms. These contacts become a channel through which knowledge can diffuse within and between organizations, including organizations in other cultures.

In the studies summarized here, we have treated the firm as a black box. We have ignored the presence or absence of networking individuals through which knowledge travels. To better understand how collective learning by organizations unfolds, we really need to have access to their social capital. From social psychological studies we know that individuals, endowed with social capital are more adaptive, live longer, perform better academically and economically (compare, Coleman, 1988). Only recently, we begin to address the advantages of social capital at the organizational level of analysis. We can expect that firms which expand abroad will enjoy higher degrees of learning if they create personal linkages so that spillover of know-how does indeed occur (compare Buono and Bowditch, 1989).

It is rather plausible to interject social capital as a condition for organizational learning across national borders. We have seen that firms become flexible, and adaptive in dealing with new decisional conditions, like those involving the implementation of ventures in alien cultures. They do so even more whenever they work through other organizations, as illustrated by improved survival rates if the firms have had a history of acquisitions or joint ventures. Such prior conduct confers a greater chance of success when contemplating expansion decisions in the future. We can only surmise that the individuals behind those interfirm activities play a crucial role in the transfer of knowledge about distant cultures and the challenges they bring about It is highly likely that cultural barriers are much higher if the individuals at the boundary of the firm were not instrumental in the diffusion of that knowledge. Japanese firms like SONY, KAO and Toyota have been particularly successful in the assignment of personnel to bridge the distance between the home country organization and organizations in distant countries through which they seek entry into those countries.

The growing interdependency across national borders, the widespread presence of joint ventures among firms, combined with the rise of the *networking organization* in general, will force us to face the issues of organizational decision-making under divergent conditions in a wholly new light. The unification of Western Europe, Pacific Rim or North America, and even the opening up of Eastern Europe are merely the frame within which expanding firms operate. They have to implement the decisions that multinational contexts impose on them. The studies reported here shed some light on the hurdles they face and the promise of experiences in overcoming these hurdles.

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