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Effects of International Experience and Legitimacy on the Performance of Greenfield Investments

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EFFECTS OF INTERNATIONAL EXPERIENCE AND LEGITIMACY ON THE PERFORMANCE OF GREENFIELD INVESTMENTS

ABSTRACT

Greenfield investments are considered high risk-involved foreign entry mode choices by companies expanding their business operations overseas. This entry mode choice requires the company to set up all its operations from the stretch on its own. While trying to perform well in the foreign setting, top managers' international experiences will play a critical role. In addition, whether this wholly-owned subsidiary "fits" well within the foreign setting will become another important factor in achieving positive performance outcomes. In my conceptualization, I argue that the TMT international experience positively affects the greenfield investment performance and this relationship is moderated by the organizational legitimacy.

Keywords: Greenfield investments, TMT international experience, Organizational legitimacy.

INTRODUCTION

The foreign entry mode choice is a very difficult, strategic decision for firms expanding their operations overseas since this choice requires them to determine how much risk they are willing to take and how much resource commitments they can make (Agarwal and Ramasmavi, 1992). Andersen (1997) defines the process of foreign entry as "an institutional arrangement for organizing and conducting international business transactions" (p. 29). In general, the main goal of the foreign entry process is to "choose the entry mode that offers the highest risk-adjusted return on investment" (Agarwal and Ramasmavi, 1992: 3).

Anderson and Gatignon (1986) argue that foreign entry mode decisions can be considered "a trade-off between control and the cost of resource commitments, often under conditions of considerable risk and uncertainty" (p. 3). In other words, these firms expanding overseas will need to strategically evaluate all *cost and control* related factors while deciding which entry mode can suit their needs better (Brouthers and Hennart, 2007). In the literature, greenfield investments are considered high-risk involved entry mode choices since the level of uncertainty for the future welfare of these wholly-owned subsidiaries tends to be relatively high compared to other entry mode options (Dikova and Witteloostuijn, 2007). Therefore, it is very important to understand and examine key success factors for greenfield investments.

The international experience of top managers can become a key element while dealing with uncertainty in the foreign setting in order to make good strategic decisions leading to positive performance outcomes (Ahorani, Tihanyi, and Connelly, 2011). In addition to that, these previous international experiences will serve as an important tool for better understanding new market conditions and expectations (Athanassiou and Nigh, 2000). Basically, executive's international experience can benefit greenfield investments in regard to better establishing their business "roots" in the foreign setting as well.

Therefore, this early-stage paper conceptually examines two critical antecedents of the performance of greenfield investments including TMT international experience and organizational legitimacy. More specifically, in this conceptual model I argue that TMT international experience positively influences the performance of greenfield investments and this relationship is mediated by the organizational legitimacy. My theoretical arguments are grounded in the internationalization and upper echelons theories. This conceptual framework can be seen in Figure 1.

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THEORY DEVELOPMENT

TMT International Experience

According to the upper echelons theory, executives' previous experiences influence their strategic choices and organizational performance outcomes (Hambrick and Mason, 1984). In the context of global business, the international experience of executives strongly encourages upper echelons' members to "consider internationalization a more viable avenue for expansion" overseas (Carpenter, Pollock, and Leary, 2003: 808). O'Reilly, Synder, and Boothe (1993) also argue that the experience factor, in general, is critical for key decision-makers since it helps them better communicate their thoughts with their industry partners and in turn make better strategic choices towards continuous progress and long-term success.

Carpenter (2002) states that the international experience of top managers can be assessed by “team members’ years of experience accrued in international assignments” (p. 280). Through their international experience, top managers will be able to analyze the environment via using an international “lens” (Guna and Jalland, 1996). More specifically, “such experience may enable executives to integrate the learned culture with their own, to easily obtain information from their external relations, to garner important insights into overseas markets via contact with foreign entities, and to reduce the anxiety associated with operating under more complex and ambiguous conditions” (Chen, 2011: 338). This means that the international experience of executives becomes a strategic “connector” between their home country conditions and host country expectations during the process of expanding overseas.

Gomez-Mejia (1988) argues that operating overseas requires dealing with more complex and uncertain situation than those in the home country, which may result in creating more complicated instances to be resolved by top managers. The experience factor becomes very critical for top managers due to affecting their ability to process information effectively (Kor, 2003), which also helps these executives better cope with up both the complexity and uncertainty (Finkelstein, Hambrick, and Cannella, 2009). Thus, the international experience of executives can be seen as a key success factor for firms expanding their operations overseas.

As full-ownership entry modes, greenfield investments require top managers to deal with high risk stemming from the uncertainty and unfamiliarity within the new, foreign environment, where these managers are going to be in full control of operations in their host location overseas (Liang, Musteen, and Datta, 2009). Although greenfield investments are expected to provide the firm with higher returns, these potential returns come with higher risks (Liang et al., 2009). For instance, Musteen, Datta, and Herrmann (2009) argue that in greenfield investments, due to environmental uncertainties as well as other external risks such as the political and economic risks, these wholly-owned subsidiaries need to "develop their own knowledge base and competencies to function effectively in foreign environments" (p. 323). In addition, making a substantial investment at a foreign location without having any partners can certainly lower the strategic flexibility of these subsidiaries, which may become another big source of risk for this foreign entry mode choice (Musteen et al., 2009).

According to the internationalization theory, key decision-makers in organizations have to make two particular decisions regarding the foreign entry: the selection of the international market and the choice of foreign entry mode (Bradley, 1995). This theory also suggests that the experience factor becomes particularly important while expanding operations overseas since executives' experiences lead to better learning (Brouthers and Nakos, 2004). Through learning, firms can "develop expertise in managing foreign operations" (Brouthers and Nakos, 2004: 233). From the perspective of TMT international experience, executives' previous experiences may significantly help these subsidiaries better integrate and organize their operations within their new foreign environment. In other words, the international experience that top managers possess will serve as a strategic "facilitator" while engaging in new business operations overseas. Due to their foreign experiences, top managers of these subsidiaries will have the strategic advantage of better understanding the external environment of the firm, analyzing it more effectively, and making their decisions more efficiently by considering a variety of factors and conditions specific to the new foreign setting. Therefore, I argue that the international experience of top managers will positively affect the performance of greenfield investments.

Proposition 1: *TMT international experience and the performance of greenfield investments are positively related.*

Organizational legitimacy

Woodward, Edwards, and Birkin (1996) define the organizational legitimacy as "the sharing of common values between the organization and the social system in which it exists - organizations are 'legitimate' to the extent that their activities are congruent with the goals of the superordinate system" (p. 330). They also argue that establishing connections between the firm and its environment will require the firm to come up with strategies that facilitate this process (Woodward et al. 1996). In addition, Suddaby and Greenwood (2005) argue that the "legitimacy is a crucial element in the creation and survival of new organizational forms" (p. 37). By following all these definitions in the literature, it can be argued that the legitimacy is an institutional explanation of a firm's existence in its unique setting in which it tries to survive.

Suchman (1995) argues that the legitimacy stems from the "congruence between the organization and its cultural environment" (p. 573). Maurer (1971) also argues that the process of legitimation refers to the one "whereby an organization justifies to a peer or superordinate system its right to exist" (p. 361). Basically, the legitimacy can be considered a combination of desirable (or acceptable) norms and values that provide an organizational entity with a strategic guidance that helps to better understand and adapt to the environment (Suchman, 1995). Thus, becoming "legitimate" can provide an organization with the stability and credibility in order to survive in the long term in the "brand new" environment (Suchman, 1995).

According to Scott and Lane (2000), the organizational legitimacy reflects "a generalized perception that an organization is behaving appropriately according to some culturally shared definitions of what is appropriate" (p. 49), which has an impact on the "perceived attractiveness of organizational images" (p. 49) to both stakeholders of the firm and the community overall. In other words, “legitimate” organizations have the advantage of reaching out a broader set of “audience” via their “socially-accepted” status. This institutional condition is considered a complicated process in which all stakeholders become a part of in order to better assess an organization’s “conformity to a specific standard or model” (Ruef and Scott, 1998: 880), which also provides the firm with a stronger strategic direction towards a better future.

Since greenfield investments are newly-formed entities at a foreign location, it will be very critical for them to establish their legitimacy in order to stay competitive among their local rivals and survive in the long-run. In other words, becoming an “accepted” member of the new foreign setting will help these subsidiaries gain positive performance outcomes via achieving both expectations and requirements of environmental success parameters. As discussed earlier, international experiences of executives will help them better understand and analyze the external environment and make better strategic decisions accordingly. Their effective analyses of the new foreign setting via using an international “lens” will help greenfield investments become a “legitimate” member within its community in a shorter time frame. In other words, TMT international experience will serve as a critical antecedent for the organizational legitimacy in the context of greenfield investments, which, in turn, helps to achieve better performance outcomes. Therefore, I argue that the organizational legitimacy mediates the relationship between the TMT international experience and the performance of greenfield investments.

Proposition 2: *The relationship between the TMT international experience and the performance of greenfield investments is positively mediated by the organizational legitimacy.*

DISCUSSION

Foreign entry mode decisions are considered very critical due to both future risks and returns stemming from these strategic actions. While deciding the most appropriate entry mode, firms particularly need to evaluate their resource availability as well as need for obtaining control (Agarwal and Rawasmavi, 1992). Greenfield investments are considered the riskiest entry mode decision since they require full resource commitment by the parent firm as well as critical managerial skills and organizational capabilities in order to "safely" execute business operations overseas in order to maximize the firm's efficiency and effectiveness in the long-term.

The unique condition of being "brand new" subsidiaries overseas puts top managers of greenfield investments in a challenging situation that they must critically meet demands of both internal and external stakeholders. Since the environmental uncertainty and unfamiliarity can be considered two important sources of corporate failure for greenfield investments, executives with previous international experience can help these subsidiaries overcome those challenges in the most optimal ways. In addition to that, these international experiences will particularly enable executives to have a better understanding of international markets (Carpenter and Fredrickson, 2001) so that they can better analyze and resolve those complex issues in a timely-manner. By doing so, these top managers will also help their subsidiaries become "legitimate" members of their community. Thus, these distinct experiences of top managers will help greenfield investments become successful companies via establishing legitimacy in the foreign setting.

CONCLUSION

This very early-stage conceptual study examines two antecedents of success parameters for greenfield investments. In particular, I argue that TMT international experience will have a positive impact on the performance of greenfield investment and this relationship is mediated by the organizational legitimacy. By looking at both team-level and institution-level constructs, I try to explain why some greenfield investments perform better than others.

This “in-progress” research certainly has some limitations. First, it only looks at the international experience as a team-level construct. Second, it does not take board characteristics on the performance of greenfield investments into account. Third, it does not consider possible effects of environmental dimensions. However, these limitations can certainly be addressed in the future. First, it would be helpful to examine impacts of some other TMT characteristics on the performance of greenfield investments. Second, it would be fruitful to examine how the board of directors might play a significant role in this context. And finally, it would be important to look at whether environmental dimensions might affect relationships explained in this model.

In conclusion, this conceptual framework offers a unique perspective in explaining the performance of greenfield investments. By using arguments of internationalization and upper echelons theories, this paper also provides practitioners with a different viewpoint in regard to the important connection of TMT characteristics (e.g. international experience) and institutional conditions (e.g. organizational legitimacy) while explaining success parameters of greenfield investments.

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FIGURES

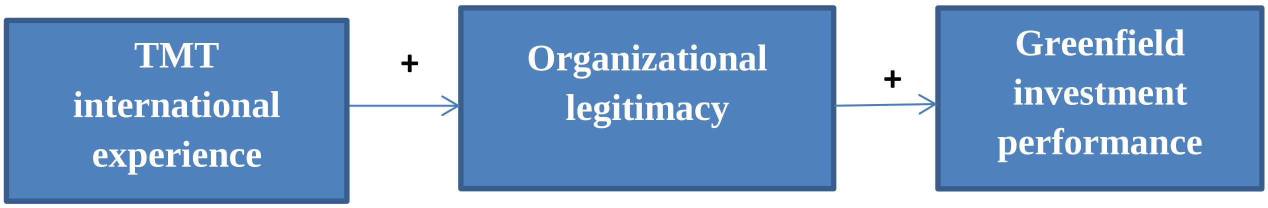

Figure 1 The performance of greenfield investments