

# Absorptive Capacity Relevance for Born-Global Firms: A Review of Literature

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**Abstract:** While most organizations are still rooted in their home country, many firms are now moving towards transcending their historical home boundaries, adopting a truly metanational approach in terms of location, resources and processes. The purpose of this perspective paper is to report and synthesize literature on the pivotal role of Absorptive Capacity and knowledge competence in expansion of firms' global footprint. The study comprises of pertinent systematic literature on knowledge competency, absorptive capacity and growth of new international firms. Knowledge competency, the paper argues, is a solid underpinning for the superior international performance of born global firms moderated by the cumulative, self reinforcing capability of a firm to exploit any critical external knowledge. The acquired knowledge and capabilities can then be leveraged on to enable a firm internationalize soon after its inception.

**Keywords:** Absorptive Capacity, Knowledge competence, Internationalization, Born – Global firms, Competitive Advantage.

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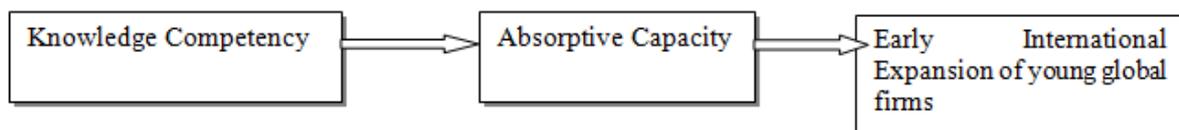
## I. Introduction

In the current competitive landscape, scholars converge on the idea that knowledge, innovation and capabilities lie at the core of the creation and sustenance of competitive advantage (Knight & Cavusgil, 2004; McEvily & Chakravarthy, 2002; Grant, 1996a). The evolution of the global economy and improved access to goods and resources from distant locations has placed knowledge at the core of firms' competitive advantage (Zander & Kogut, 1995; Jensen & Szulanski, 2007; Sala, Osirio, Blanke, Geiger & Ko, 2012). Firms increasingly build their competitiveness by tapping into external knowledge sources (Chesbrough, 2003; Laursen & Salter, 2006). At the same time, it is widely accepted that critical knowledge is not always easily available through external sources (Argote, 1999), which fosters a need for creating knowledge internally (Nonaka, 1994). However, with respect to both modes of knowledge sourcing, the capacity to absorb knowledge has become crucial.

In their seminal papers, Cohen and Levinthal define absorptive capacity (AC) as the “ability to identify, assimilate, and exploit knowledge from the environment”(1989,1990,1994).The increasing number of publications that apply, measure or extend their concept of AC definitely reflects the high absorption of the relatively new AC notion in the organization field. Scholars have “recognized” the richness of the concept and “assimilated” the concept through renewing theories, developing conceptual models, and conducting various empirical studies. To this end, this study focuses on the early internationalizing firms, hereto referred to as ‘born-globals’ on leveraging capabilities needed to achieve their international goals. Amongst numerous capabilities that would be needed to steer a firm towards making a successful global footprint is the Absorptive Capacity (ACAP).This is further discussed in the later sections of this article.

Reviewing literature on knowledge competency, absorptive capacity and expansion of born-global firms, this study aims at addressing the following research questions:

1. Is there a relationship between knowledge competency and international expansion of born-global firms?
2. Is the relationship between knowledge competency and international expansion of born-global firms moderated by the firm's absorptive capacity?



**Figure 1:** Framework

**a) Independent Variable:** A firm's Knowledge competency is taken to be the independent variable and explored in detail to illustrate that appropriate acquisition of requisite competence/knowledge arbitrated by a

firm's absorptive capacity leads to faster internationalization of firms.

**b) Dependent variable:** Early Internationalization is assumed to be the dependent variable which is caused by proper acquisition and exploitation of knowledge and competencies through the intervention of absorptive capacity.

**c) Mediating variable:** The mediating variable considered for this research is firm's absorptive capacity. This discussion depicts that the mediating variable acts as an intermediate effect to ultimately lead a firm's international expansion.

## II. Review Methodology

This study uses purely extensive literature search, through academic databases, online search engines and review of references of related studies. Content analysis is done on 20 peer-reviewed articles from 12 journals for quality appraisal and synthesis, and the results presented as discussions on various sections of this paper leading to answering of the key research questions. Table 1 shows the distribution of these articles with respect to journals.

**Table 1: Distribution of the Articles with Respect to Journals**

JOURNAL	QUANTITY
Academy of Management Journal	3
Journal of Small Business Management	1
Journal of Management	1
Journal of International Business Studies	3
Journal of International Entrepreneurship	1
Management International Review	1
Journal of Innovation Economics	1
Strategic Management Journal	3
Journal of Business Venturing	1
Asia Pacific Journal of Management	2
The Economic Journal	1
Organization Science	2

## III. Theoretical Review Of Literature

### 'Born-Global' Concept

Since the 1980s, a growing number of firms have challenged the traditional stages models by simply being start-up firms with limited resources and no international market experience and still successfully competing on international markets. In Aspelund and Moen (2012), Rennie (1993) called them Born Global firms. The term was broadened by Oviatt and McDougall (1994) by introducing the concept "International New Ventures", defined as a "business organization that, from inception, seeks to derive significant competitive advantage from the use of resources and the scale of outputs in multiple countries". Later, several studies have described the same phenomenon, with labels like "Instant Internationals" and "Global Start-ups" Evidenced by extant literature in the topical area of internationalization of firms, it is clear that a burgeoning number of small firms are becoming international at or near their founding, irrespective of the psychic distance involved, through diverse entry modes (Knight & Cavusgil, 1996, 2004; McDougall & Oviatt, 1996; Oviatt & McDougall, 1994). International New Ventures (INV's) or global start-ups, have come of age during the current era of globalization and advanced globalization. Consistent with other scholars, Autio, Sapienza and Almeida (2000); Knight and Cavusgil (1996); Oviatt and McDougall (1994); Rennie (1993), born globals are defined as business organizations that, from or near their founding, seek superior international business performance from the application of knowledge-based resources to the sale of outputs in multiple countries.

By embracing internationalization almost from inception born global firms avoid incremental and time consuming acquisition of experiential knowledge abroad (Knight & Cavusgil, 1996). Theoretical insights from the international entrepreneurship literature emphasizes how the dynamics of Internationalization of born global firms lead to superior performance (Etemad and Wright, 2003; Knight and Cavusgil, 2004; Oviatt and McDougall, 2005). Oviatt and McDougall went further to build a model that tries to explain the observed differences in the speed with which entrepreneurial opportunities are taken international. The internationalization process of small entrepreneurial firms is far from the linear and time-prolonged process used in the traditional stage theories of internationalization (Johanson and Vahlne, 1977, 1990, 2006 and Vernon 1966, 1971, 1979). Instead, many entrepreneurial firms start their international activities at foundation entering

different countries simultaneously.

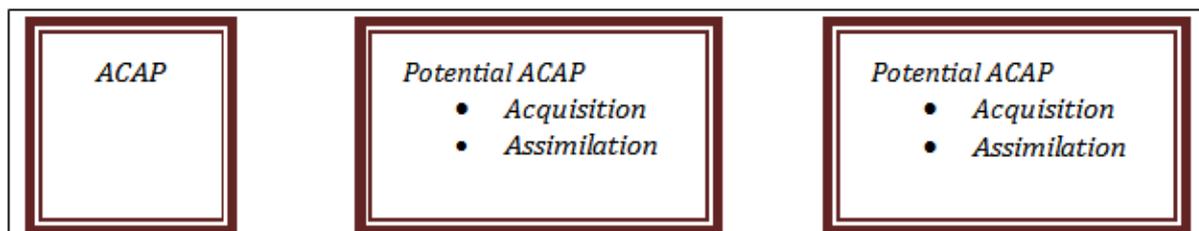
Born global firms tend to take advantage of the competencies obtained from their partners or strategic alliances especially those in distribution channels (Madsen and Servais, 1997; Burgel and Murrey, 2000). In particular, their learning capabilities allow them to develop knowledge-based intangible assets, products or services and also business processes that can be internally replicated and transferred by means of diversification and international expansion (Stalk et.al, 1992; Teece et.al, 1997; Zahra and George, 2002). Whereas new firms used to almost always suffer the disadvantage of being new and small because they lacked resources and experience; some are now developing capabilities that allow them to overcome the impediments. Autio et.al (2000) asserts that the disadvantages of being new, small and foreign are compensated by the learning capability these firms possess and take advantage of. Theoretical support for born-global firms is derived initially from innovation theory, which views innovation as the pursuit of novel solutions to challenges that confront the firm, including the creation of new products and the pursuit of new markets (Miller & Friesen, 1984 in Gary et al, 2004). In the context of pursuing new markets, internationalization is an innovation within the firm (Cavusgil, 1980) and innovation theory provides a useful framework because, even in the face of limited financial and human resources, early internationalisation is a fundamental characteristic of born-global firms.

### **Absorptive Capacity (ACAP) as a Firm's Dynamic Capability**

From their seminal article over two decades ago, Cohen and Levinthal (1990) introduced the concept of Absorptive Capacity (ACAP) which is today a very established construct in Literature and in practice. Defined by Cohen and Levinthal as 'the capacity to recognize the value of new external information, assimilate it and apply it to commercial ends', Zahra & George, (2002) view ACAP as an allusion to the range of routines and organizational processes through which a business or a system acquires, assimilates, transforms and exploits knowledge in order to produce a dynamic organizational capability. Helfat et al. (2007:30) defines Dynamic Capability as "the capacity of an organization to purposefully create, extend or modify its resource base". Van Den Bosch et al. (2005) proposes a definition of ACAP based on three crucial components: the capacity to recognize the value of external knowledge, the capacity to assimilate it and the capacity to apply it for commercial purposes. This is what Kim qualifies as the capacity of organizations to learn and to solve problems (Kim, 1998). As noted by Zahra and George, ACAP potentially bridges between the fields of dynamic capability (Teece, Pisano & Schuen, 1997; Eisenhardt & Martin, 2002; Zollo & Winter, 2002) and organizational learning (Fiol & Lyles, 1984; Easterby-Smith, 1997; Akgun, Lynn & Byrne, 2003). On one hand it draws attention to the need to appreciate and acquire

Knowledge from the external environment, especially from acquisitions and other interorganizational relations; on the other it focuses on learning from past experience and current actions, and the internal processes for translating this into useful action. Other numerous studies have demonstrated the connection between absorptive capacity and organizational performance (Cohen & Levinthal, 1990; Levinson & Asahi, 1995; Mowery & Oxley, 1995; Gao, Xu & Young, 2008). For an organization to increase its absorptive capacity, it needs to boost its ability to transform and implement external knowledge within the company so as to enhance its core competencies (Daghfous, 2004). Internationalization knowledge, defined as "...knowledge that reflects a firm's resources and its capabilities for engaging in international business" (Johansen and Vahlne, 2009) is considered very critical in the internationalization process. Havn (2012) notes that general internationalization knowledge could be sourced from a firm's experience with foreign market entry, mode of expansion, core business, alliances, acquisition among other firm experiences.

This study therefore affirms that absorptive capacity which is seen as a 'cumulative, self reinforcing capability that makes it easier for a firm to exploit any critical external knowledge that may become available' is a fundamental concept in the study of organizational learning and well leveraged, could contribute to successful international expansion of a firm.



**Figure 2:** Absorptive Capacity Construct

Source: Adopted from Zahra, S. & George, G., 2002, 'Absorptive Capacity: A review, reconceptualisation and

extension', *Academy of Management Review* 27(2), 185 - 203

### **Internationalization Process of Firms.**

Different internationalization trajectories allow for some useful insight into firms internationalization strategies. As documented in his paper on 'Internationalization of SME's', Laghzaoui (2011) notes that there are three principal types of dominant explanations on Internationalization Approaches namely; Stages Approach (comprising of Uppsala and Innovation model), Economic Approach and Networks Approach. For the purpose of this study we look at the heavily documented Uppsala model and network model for the very reason that both are based on the assumption that developing knowledge is fundamental to a firm's internationalization.

Stages Approach. These models converge on the idea that internationalization is a linear and sequential process composed of stages 'chain of establishment' (Coviello & McAuley, 1999 as cited in Laghzaoui, 2011). The Uppsala Model (Johansen and Vahlne, 1997) and the Innovation -related Internationalization Model (Bilkey and Tesar, 1997; Cavusgil, 1980; Czinkota, 1982; Reid, 1981) are considered to offer dominant theoretical explanation of this approach. Though revisited in their latest publication of 2009, Johansen and Vahlne (1977) observed from their empirical observations of Swedish Owned subsidiaries abroad that companies followed a sequential process made up of four stages which was labeled as establishment chain: Activities of irregular and opportunist exports; Export via an independent agent; Establishment of subsidiaries of sales; and Production in the foreign country.

The second feature Johansen and Vahlne considered was psychological distance, which takes cognition of the cultural and linguistic differences that make it difficult to understand foreign environment. The model conclusively emphasizes on two change mechanisms that would see the firms incrementally but successfully navigate through the challenges of expanding abroad. These were 'Learning from their experience' of operations and current activities in foreign markets as well as 'Firm Commitment' to strengthen its position in the foreign market. Commitment was defined as the unwavering dedication to meet the needs of customers. Experience builds a firm's knowledge of a market and the body of knowledge influences decisions about the level of commitment, which engenders more learning (Johansen and Vahlne, 2009). Thus, by integrating knowledge drawn from the experience on the foreign markets the company feeds its decision-making process and reduces the psychological distance.

Network Approach. In their revisited model of the internationalization process Johansen and Vahlne observe that a firm is embedded in an enabling and at the same time constraining business network that includes actors engaged in a wide variety of interdependent relationships. Internationalization is seen as the outcome of firms' action to strengthen network positions by improving or protecting their position in the market. As networks are borderless, the distinction between entry and expansion in the foreign market is less relevant.

Johansen and Vahlne view the present business environment as a web of relationships, a network, rather than as a neoclassical market with many independent suppliers and customers. Hence, it is critical for any firm to leverage on such networks to enhance their growth. From their examination on how three firms entered foreign markets, Axelsson and Johansen (1992) showed that foreign market entry should be studied as a position building process in a foreign market network. A rapidly growing number of modern firms are built around a brand, a design or patented technology for which production and services are performed by a network of other firms. International theorists therefore contend that Business network model would be very useful in enhancing understanding of firms' internationalization.

### **Knowledge Competence and International Expansion of Firms**

Firms that pursue international expansion at or near their establishment may need to develop their competencies to achieve a competitive edge, albeit transient, over their competitors (Baum et al., 2011). Existing literature affirms that an organization's knowledge competency appears to be a prerequisite for its performance in an international context (Jantunen et al., 2005). Previous studies (Becker & Peters 2000; Bergh & Lim 2008; Chen 2004; Daghfous 2004; Gray 2006; Holmqvist 2003 and Saghali & Allahverdi 2011) have underscored the significant role played by knowledge and organisational learning in enhancing competitive advantage. By exploitation, organisations are able to learn how to improve their capabilities, make use of their present knowledge base and pay attention to existing activities in current domains (Holmqvist 2003). Furthermore, through knowledge routinisation and refinement, exploitation is able to help organisations realise reliability in experience (Holmqvist 2004). An organisation should be able to recognise, anticipate and consequently take action in response to market shifts or new technological developments in a manner that is superior to its competitors. Knight and Cavusgil (2005) contend that early internationalizing firms must possess "specific knowledge-based internal organizational capabilities that support both early internationalization and subsequent success in foreign markets." This posits that specific international organizational capabilities, such

as knowledge accumulation and proprietary technology development, are indispensable for effective international performance. According to the resource-based view (Barney, 1991), a firm's ability to gain and manage proprietary resources that are important to the firm is at the heart of sustained competitive advantage. This perspective indicates that enhanced knowledge competency based on resources leads to superior performance. One plausible inference is that the competency may be characterized as "a firm-specific advantage being easily inimitable" (Buckley and Casson, 1976). Further, the well-built knowledge competency may serve to prevent limited resources from restricting the potential growth opportunities of born globals in their internationalization process, thus providing a competitive basis for international success. Zahra et al. (2000) suggest that international performance is driven by the firm's ability to create knowledge by combining it for purposes that suit the requirements of international markets. In consequence, the enhancement of knowledge competency is regarded as a solid underpinning for the superior international performance of such businesses (Knight and Cavusgil, 2005).

Drawing from prior literature on the effects of knowledge competency on the international performance of early internationalizing SMEs, Autio et al. (2000) found that the competencies with greater learning-based knowledge intensity were positively associated with growth in international sales.

#### **IV. Results**

The discussions above reveal that, irrespective of a firm's age in the industry, it can benefit significantly from ACAP. The disadvantages of being new, small and foreign are compensated by the learning capability these firms possess and take advantage of. The study further reveals that ACAP is a strong predictor of an organization's growth, specifically international expansion and hence, the capability to explore and exploit knowledge is a key strategic asset for the organization. Young organizations with high levels of ACAP are able to acquire and exploit relevant knowledge within their processes and come up with strategies that give them a faster global footing. Addressing the research questions, this discussion indicates that there is a positive relationship between knowledge competency and international expansion of a firm, a relationship that is moderated by the firm's level of absorptive capacity.

#### **V. Conclusion And Future Research Direction**

This perspective paper is aimed at enhancing our understanding on the relevance of the absorptive capacity in the rapid internationalization of new ventures. The discussion above contends that multiple strands of literature have shared observations and assertions on the relationship between the absorptive capacity of a firm and its international expansion. The concept of absorptive capacity emerges as the central element to describe the learning capability of firms in internationalization process. Enhancement of knowledge competency is regarded as a solid underpinning for the superior international performance of born global firms. An emerging feature on the reviewed literature is that the previous empirical studies were conducted in developed countries (USA- Knight & Cavusgil, 2004; Europe – Johansen & Vahlne 1977,...) and it would therefore be imperative for a similar study to be conducted in the context of developing countries. A further exploration of other aspects such as comparative advantage of firms which has not emerged in the existing literature would be necessary to determine if they have a role in driving early internationalization of firms especially in developing countries.

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