

Should Birds of a Feather Flock Together?

Agglomeration by Nationality as a Constraint in International Expansion

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Introduction

National identity is an important magnetic force that draws individuals and organizations to co-locate in the same geographic areas in foreign countries, thus providing a fertile socio-economic context for relationship formation and other social exchanges. Whether the focus is on individuals such as Chinese immigrants in Metropolitan cities (Zhou & Logan, 1989) or organizations such as Korean firms in China (Guillén, 2002), numerous studies have examined the factors that result in agglomeration by nationality (Henisz & Delios, 2001) and its consequences (Hernandez, 2014). Most research on nationality-based agglomeration of individuals highlight that shared cultural backgrounds and languages provide immigrants with a familiar and comfortable environment like that of their home country when they relocate overseas (Edin, Fredriksson, & Åslund, 2003). Similarly, most research on firms agglomerated by nationality highlights the positive consequences of co-location such as the social capital and local knowledge residing in co-national immigrant communities (Hernandez, 2014) and easier communication and knowledge sharing among co-national firms (Miller, Thomas, Eden, & Hitt, 2008). Moving beyond the positive consequences of nationality-based agglomeration for firms in foreign markets, my dissertation emphasizes the negative consequences as well and shows that agglomeration by nationality, paradoxically, both enables and constrains the innovation activities of firms in foreign markets.

Summary of Dissertation Research

By facilitating knowledge transfer across firm boundaries and creating collaborative opportunities, the clustering of firms in similar industries has long been highlighted as a facilitator of innovation (Porter, 1998; Saxenian, 1994). Agglomeration of firms by their nationality, however, may not always facilitate innovation, but can instead hinder innovation. Distinguishing between exploitative and explorative innovations (March, 1991), the main argument of this study is that agglomeration by nationality can pose a trade-off by facilitating exploitative innovation, while simultaneously hindering explorative innovation. First, agglomerating with same-nationality firms entails widely shared social structures, procedures and cultural norms that can be translated into refining and extending existing competencies, and therefore enhance exploitative innovation (Benner & Tushman, 2003). The same social structures and cultural norms that facilitate exploitative innovation may, however, hinder access to new knowledge bases and experimentation that are necessary for explorative innovation (Levinthal & March, 1993). To further explore the important trade-off between exploitative and explorative innovation caused by agglomeration by nationality, I identify and test three important mechanisms—employee recruitment, alliance partnering, and

innovation strategy—that account for both the positive effects of agglomeration by nationality on exploitative innovation and the negative effects on explorative innovation. In other words, this study extends our prior understanding of agglomeration and innovation by showing that agglomeration by nationality can have both positive and negative consequences on innovation, and by further unpacking the behavioral mechanisms that account for the trade-off of agglomeration by nationality on exploitative and explorative innovations.

I study the consequences of agglomeration by nationality in an international setting in which firms expand to a foreign market to obtain new knowledge and enhance their innovation capabilities. I use a sample of non-US pharmaceutical firms that locate their R&D facilities in various US locations from 1980 to 2006 and examine how these firms may face a trade-off in terms of exploitative and explorative innovation by agglomerating with other same-nationality pharmaceutical firms. To further explore the mechanisms by which agglomeration by nationality impacts innovation outcomes, I examine the nationality of the employees, the nationality of the alliance partners and the imitation of technological trajectories of same-nationality firms in the focal foreign location. The results largely confirmed the theoretical arguments: First, co-locating with more firms from the same home country leads to an increase in the number of exploitative non-NME (new molecule entity) patents generated in the focal foreign location but a decrease in the number of explorative NME patents. Second, the results also showed support for two of the proposed behavioral mechanisms explaining the trade-off: Having a higher composition of same-nationality employees and imitating technological trajectories mediate the impact of agglomeration by nationality on exploitative and explorative innovation performance.

Contributions

My dissertation offers important theoretical contributions to research. First, not many studies examine how the consequences of agglomeration may differ depending on the characteristics of individual firms and the characteristics of the cluster. Most research on the negative externalities of agglomeration focus on the increased competition for limited resources or unintended knowledge leakage (Baum & Mezias, 1992). By emphasizing that national identity is an important factor explaining firm behavior within clusters, my study adds that negative externalities of agglomerating above and beyond simply increasing competition exist. More related, few studies have argued that firms actually incorporate a balanced view of both the gains from others' knowledge spillovers and the losses from their own knowledge leakages and, depending on their technological capabilities, make different location decisions (Shaver & Flyer, 2000). By emphasizing both the positive and

negative outcomes of agglomeration, my study recognizes that agglomeration implies important trade-offs, thus showing that a nuanced approach is necessary in agglomeration research to understand the dynamics within clusters.

Second, this study contributes both theoretically and empirically to research on the impact of nationality on foreign market entry by theorizing and empirically testing effects of agglomeration by nationality after the initial entry. Prior research on foreign market entry has highlighted the imitative behavior of other firms from the same home country when choosing locations in foreign markets (Henisz & Delios, 2001). I shift the attention from the entry stage location choices and focus on firm behavior and performance after the initial entry to show the consequences of agglomerating by nationality. The findings emphasize the importance of taking a long-term perspective in foreign location choice given that the benefits at initial entry may not always translate into positive performance outcomes but sometimes hinder full exploration of the new opportunities in foreign locations.

This study has important implications for managers and policy makers as well. Research on ethnic enclaves has highlighted the benefits of agglomerating in foreign markets and shown that individuals that participate in ethnic enclaves have, on average, higher earnings than those who do not (Edin et al., 2003; Portes, 2010; Zhou & Logan, 1989). Often times, when firms are setting up foreign subsidiaries, employees from the home country are sent to the foreign location as expatriates. These individuals, as pointed out in ethnic enclave studies, tend to gravitate towards co-ethnic communities. The expatriate families that work in New York, for example, have sorted into expatriate communities in Westchester—the French in Larchmont, Germans in White Plains, Japanese in Scarsdale, and so on (Foderaro, 2000). By highlighting the trade-off of agglomeration by nationality for organizations, this study points to an important tension for firms when choosing locations in terms of balancing the social life of expatriates while taking advantage of the diverse knowledge pool for innovation at the firm-level. Fortunately, my focus on the mechanisms behind the innovation trade-off also points to manageable solutions including emphasizing national diversity in employee recruitment to limit the identified downsides of agglomeration by nationality.

Overall, my dissertation develops a nuanced and rigorous account of how national identity, a neglected aspect of agglomeration literature, affects the behavior of firms and their subsequent innovation performance in foreign markets.

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