Does prior experience really pay?: The types of prior experience and mechanisms that lead to performance improvements

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Abstract:

Many scholars have demonstrated that prior experience with foreign direct investment leads to future performance improvements. The inference of such studies implies that firms with more prior FDI experience will outperform firms with less prior experience. However, two aspects of this theoretical view remain unclear. Little is known about 1) which types of experience lead to firms future performance improvements and 2) the specific mechanisms that are driving this performance. Theoretically, experienced firms should benefit from a learning effect from prior knowledge that enables them to improve proficiency in subsequent risk mitigation decisions. I posit this only holds true when prior experience is that of a similar institutional environment. First, I reexamine the hypothesis that prior experience leads to future performance improvement by demonstrating that firms with similar prior institutional experiences are more likely to experience market success than firms with less similar experiences. Second, I examine the capital budgeting framework of each firm to determine the mechanisms of prior experience that lead to subsequent success and find that firms with similar prior experiences are more successful due to three differentiating mechanisms: 1) their ability to select better projects exante entry, 2) their ability to more accurately predict the cash flows and 3) their ability to mitigate the risk of market fluctuations. Moreover, these competencies lead to a lower likelihood of market failure driven by cash flow limitations. Utilizing a hazard rate model, I examine the effects of prior institutional experience on failure rates of foreign firms who have entered the Brazilian telecommunications industry during the deregulation era from 1997-2004.
1. An investigation of prior experience and FDI entry and exit

Several scholars have demonstrated the firms with prior FDI experience are more successful in subsequent FDI ventures\(^1\). Many have attributed this success to experienced firms ability to mitigate risks more proficiently than firms that lack prior foreign direct investment experience. Generally, this theory holds true. However, most studies have not specified types of experience that lead to subsequent success or addressed the mechanism that lead to performance improvements. There are some relevant practical examples that demonstrate a necessity to probe further in this direction. For instance, why would an experienced multinational firm such as AT&T, with over 20 prior FDI experiences, exit the market in less than 5 years without making a profit while a Mexican competitor, America Movil, achieves overwhelming success and profitable growth with limited prior experience in foreign investment in less than a year? Let us further examine each of these cases. AT&T’s 5 year investment in the Brazilian telecommunications industry was marked by repeated annual losses and write-offs in excess of $120 million, decreasing annual cash flows, eventual bankruptcy, delisting from the stock exchange and continuous battles to keep up with the changing regulatory environment. This series of events lead to their eventual market exit marked by a sell-off of their assets to multinational competitors. Alternatively, America Movil entered the Brazilian telecommunications market with little prior FDI experience; however, their business results were immediately indicative of increasing market share, excellence in cash flow management with a cash flow to debt ratio exceeding all U.S. investors and rapid growth rising to the number one Latin American cellular provider. These two examples provide results counter to the theoretical predictions that prior experience should lead to performance improvements in subsequent investments. We should expect that firms with prior experience would assess the

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\(^1\) See Table 1 in the appendix for a full literature review.
risk more accurately and be more capable of mitigating the ongoing market risks from daily market fluctuations than firms with less experience because of the knowledge they bring to the decision making process from other host countries. These conflicting results suggest that there is more to understand about the relationship between prior experience and subsequent performance improvements. Perhaps these examples reveal that it is not sufficient to just have any FDI experience, but the right type of prior experience is needed to achieve subsequent performance improvements. Thus, a study is warranted to further examine both the types of experience that lead to subsequent performance improvements and 2) the specific mechanisms that are driving investment success.

This paper attempts to explore both of these issues by first illustrating the types of experience that lead to subsequent performance improvements and then providing a model of the mechanisms that drive this success. I will examine the heterogeneity of firms’ prior FDI experiences in different regulatory environments and examine how these prior experiences effect their overall ability to succeed. First, I draw on the inclination that not all types of experience with FDI aid firms in achieving subsequent performance improvements. I argue that subsequent FDI performance improvements are predicated on firms having experience in similar types of institutional environments. Thus, if firms have conducted prior investments in countries that have similar regulations and laws, they will be much more proficient at mitigating the risk of entry because of their fortitude in dealing with similar market conditions and adjust accordingly to their investment expectations. Experienced firms’ ability to transfer directly relevant knowledge from their prior experiences will likely give them an advantage in sustaining their market position over time which in turn leads to fewer market failures. Second, I present a model that clearly specifies the mechanisms operating between a firm’s prior experiences and
their subsequent performance. I reveal firms with similar institutional experience have three distinct mechanisms that are driving their success in the market: 1) their ability to select better projects ex ante entry, 2) their ability to more accurately predict the cash flows and 3) their ability to mitigate the risk of market fluctuations. I use a hazard rate model to empirically examine the likelihood of market exit given their type of prior experience. I expect to find that the effect of having similar prior experience is a more significant indicator of subsequent success than just having had any prior FDI entries. The key contributions of this paper provides scholars and practitioners alike two valuable insights. Firms can optimize their success of FDI entry by strategically investing in sequential investment patterns that maximize similar components of the institutional environments in the target host country. A key component of making this strategy effective is recognizing the similarities from one investment to the next which allows the firm to build competencies across investment experiences. Thus, experienced firms can select investments that appear to be more risky by utilizing their competencies that evolved to manage the uncertainties. The net conclusion suggests that the effects of prior experience on future investment outcomes is not solely based on having prior FDI entries, but on the type of experience acquired that provides relevant and meaningful information to help the firm accurately assess the risk of entry.

I will proceed in the following manner. I will present my theoretical arguments in the next section. Following, I will discuss the empirical setting, methods and measures that I will use to test these hypotheses. Then, I will conclude with a discussion on the expected outcomes from the empirical test and the implications for future research in this area.

2. Theoretical discussion
2.1

I will separately test two primary hypotheses in this paper. First, I will reexamine general the hypothesis that prior experience leads to future performance improvements. I depart from the existing theoretical argument by suggesting that not all types of prior experience lead to subsequent performance improvement. I hypothesize that firms with prior experience in similar institutional environments are more likely to succeed than firms with less similar experiences. In this paper, I operationalize the institutional environment as the formal regulatory that exist in each host country where a firm has experience with foreign investment. While I only address one of the formal institutional structures, there are further opportunities beyond the scope of this paper to address more inclusive dimensions of the institutional environment. Second, I clearly specify the mechanisms of prior experience that lead to firm success in subsequent investments. I argue that firms with similar institutional experience are more efficient risk mitigators than firms with less similar experiences. Their experience enables them to make more accurate valuations of a FDI opportunity ex ante entry as well as manage the unexpected market uncertainties that arise ex post entry. This acquired knowledge that enables the experienced firms to function more effectively is reflected in their ex post performance results creating a significant difference than firms with less experience. Over time, a firm’s ability to accurately predict performance outcomes ex ante leads to longer-term survival ex post entry because of the strength of their cash flow position throughout the life of the investment. I will support this argument more thoroughly in section 2.3.
2.2 First, I will elaborate on the effects of prior experience and firm success. We know that firms with more experience are likely to benefit from performance improvements because of their ability to efficiently mitigate the risk inherent to foreignness\(^2\). Experienced firms are more adept risk mitigators of uncertainties because they can foresee the inherent challenges of a new host country environment based on their prior knowledge acquired from similar experiences. However, there are many types of experience that a firm acquires from conducting FDI and it is not conclusive whether all experience leads to future performance improvements at the same propensity. I presume there are two primary types of experience that firms acquire in conducting foreign investments. Firms gain experience with FDI by estimating the tangible requirements of conducting business such as property, plant and equipment related to meeting market demands. This type of experience has a great deal of precision in estimating because of the quantifiable cost for building materials, labor inputs and capital infusions needed throughout the project and thus tends to be less risky. With frequent foreign investments, firms will likely develop competencies to accurately predict such tangible costs. Alternatively, firms can also gain experience in effectively managing the intangible aspects related to the investment such as the idiosyncratic nature of the institutional environment which has been shown to effect a firms ability to manage expropriation risks of local governments and partnering firms, manage the variances in the regulatory environment, or know which local governmental officials to bribe to improve their capacity to operate in the country\(^3\). These factors are typically more difficult to observe and predict and thus are inevitably more difficult to manage because of the vast heterogeneity of institutional practices across countries. Without having any relevant similar experiences, a firm could potentially grossly misestimate the effect of such institutional

\(^2\) Scholars (Johanson & Vahle, 1977; Davidson, 1980; Shaver, Mitchell & Yeung, 1997) have theoretically built arguments that suggest the direct benefit of firms with prior experience is their unique ability to use acquired knowledge of the market.
parameters on their business. Because of the vast heterogeneity across countries, it is more challenging for firms to build in-depth competencies across each type of experience over time.

This paper is primarily concerned with the effects of experience in heterogeneous institutional environments over the lifespan of a given investment decision. Part of a firm's success in a foreign country hinges on their understanding these institutional dimensions, including the political and governmental structures, laws, regulations and means of social interaction that has the ability to effect the appropriation and expropriation of firm cash flows. North (1991; pg97) effectively defines the institutional environment as “humanly devised constraints that structure political, economic and social interactions. They consist of both informal constraints (sanctions, taboos, customs, traditions and codes of conduct) and formal rules (constitutions, laws, property rights)”. Recent studies on FDI have begun to address a couple of the parameters of the institutional environment that effect firms foreign investments. Specifically, Henisz (2000) reveals the effects of political hazards on foreign investment strategies and Kogut & Singh (1988) examine the effects of culture on FDI decisions; however, other aspects of both formal and informal institutional environments remain sufficiently understudied. There are still several components of the institutional environment that know very little about the effects of FDI performance such as the regulatory conditions, laws, property rights as well as the behavioral norms that generate culture. In this paper, I focus on the effects of the formal institutionalized regulatory conditions within a country. Admittedly all of these institutional components are not mutually exclusive of other institutional norms and structure, so

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3 For example, Henisz (2000) suggests that firms entering global markets with a high level of political hazard (as measured by corruption and direct taxation to multinationals) are better off entering the market as a minority joint venture with a local partner to avoid governmental expropriation, but are subject to private partner expropriation.
I include the known variables as measures of control to tease out such previously studied effects (i.e., culture and political hazards).

The distinctive contribution of this study is to qualify the type of experience a firm has is a stronger determinate of success than solely examining the frequency or market penetration of an investment. For this reason, define prior experience as the following three components. First, prior experience measures whether a firm has operated in an institutional environment of a particular type based on the host country’s regulatory conditions. Specifically, I examine the regulatory dimensions of each host country to determine a composite index representative of the regulatory conditions of the respective country. Since the primary consideration is the level of similar experience between a firm’s prior experience and that of the target host country, I create a *distance* measure to capture the level of similarity that exists between a firm’s prior experience in a given regulatory environment and that of the host country of investment. Conclusively, this suggests that firms that have the least amounts of distance between their experience and the host country’s regulatory environment should have higher success than firms with dissimilar experience. Second, I incorporate a *depth* measure for the frequency of investment experience each firm, \( j \), has in each heterogeneous regulatory environment, country, \( k \). As the amount of relevant similar experiences increases, it will only aid in the survival prospects of a firm foreign investment. Likewise, as a firm lacks experience with similar institutional environments, their survival prospects will suffer from gross inaccuracies in predicting performance outcomes. Last, I create a measure, *breadth*, which captures the range of firms prior types of experience over the life of all of their foreign investments. I conjecture that firms with more variance in the types of host countries they have entered will have a greater ability to mitigate the risk of foreignness in any market environment. The net effect of there three components of prior experience suggests
that firms who have the right types of prior experiences and develop some competencies in risk mitigation in these areas will have a higher propensity to survive than firms with dissimilar types of experience and limited risk mitigating competencies developed over time.

In review of the case example presented earlier, AT&T's exit in the Brazilian telecommunications market, they clearly had prior experience with FDI by measure of their 20 subsidiaries worldwide. However, after closer investigation, they had very little similar institutional environments to the regulatory environment of Brazil. Conversely, the regulatory norms of the Mexican firm, America Movil, are very similar to the recently deregulated telecommunications industry in Brazil. This distance in the institutional environment created a gap in understanding the target host country environment and thus leads to market failure over time. I will elaborate on the mechanisms of how this occurs next.

While alternate explanations may contend that firms have different rates of learning from their own or competitors prior experiences, I do not address this perspective in the scope of this paper.

2.3 My second hypothesis focuses on the mechanisms that directly effects subsequent investment performance improvement as a function of the type of experience a firm has acquired. I build on the literature that suggests firms with prior experience have a unique ability to use this knowledge to be more efficient risk mitigators in subsequent investments. I argue that these expressed efficiencies will be observed in firms with similar institutional experience in three distinct areas related to their investment. Here I will further elaborate on this theoretical view.
There are two primary theoretical perspectives on the effects of prior experience: 1) experience leads to enhanced risk mitigation and 2) experience effects subsequent strategic decision-making. The general assumption suggests that the more experiences a firm has will lead to more success in future investments (Li, 1995; Luo & Peng, 1999; Shaver, Mitchell & Yeung, 1997). I build on both of these arguments by identifying the specific mechanisms that lead to performance improvements. We know that the decision for a firm to enter a given host country typically occurs within a firm’s established decision making framework. Depending on how proficient a firm is at decision-making ex ante the investment effects their ability to capture performance improvements learned from knowledge derived through prior investment experiences. For further elaboration of this idea, I begin with the baseline assumption that all firms assessing FDI opportunities exante entry are using a capital budgeting model, such as a net present valuation model (NPV) that aims to maximize the wealth of the shareholders through positive cash flow generation. Precisely, managers seek investments that provide the highest rate of returns amongst other investment options at the lowest level of risk. Thus, such a NPV model,

\[ NPV = C_0 + \frac{C_1}{1 + r} + \ldots + \frac{C_n}{(1 + r)^n} \]

suggests that exante entry into a given host country, firms with available cash outlays, C, in period 0 and a positive present value above the capital market return will be more inclined to invest in such foreign markets opportunities.

By using this NPV model, we can instantly observe the variance in firm heterogeneity in their ability to predict and mitigate risk. The level of precision in prediction and risk mitigation
will vary between firms given their type and level of experience with FDI in each host countries. I posit the three mechanisms of the risk mitigation that will vary given a firm’s prior experience in a similar institutional environment are:

1) ability to accurately predict cash flows, C
2) ability to select better projects resulting in more selective entry
3) and ability to mitigate the risk of market fluctuations resulting in less volatility of cash flows.

Firms that have similar institutional experience will have a higher propensity to survive because there three mechanisms generate better performance outcomes than will firms with differing institutional experiences. Such firms will be better risk mitigators because of the reduced uncertainty and greater ability to maneuver within regulatory conditions. The more similar their prior experiences are to the regulatory norms of the host country under consideration, the more relevant knowledgeable they will be about assessing the potential risks of the host country ex ante.

*Accuracy in Generating Cash Flow*

Thus, these experienced firms are more likely to understand and capture the true cost of conducting business in this type of host country. This ability to accurately predict cash flows will result in little disparity between the exante predictions and the ex poste performance results. The precision in the estimating processes directly linked with a firm’s performance in period 1 of the investment. Understanding the initial investment required, \( C_0 \), in a host country can greatly effect the outcome of a firm’s ability to generate cash for future phases of the investment and pay off outstanding debts. If the forecasted risk is underestimated ex ante, firms will suffer ex poste from cash management issues. Financial managers must make knowledgeable predictions to be able to accurately calculate the potential risks related to tangible assets requirements as well as
the idiosyncratic institutional environments. This inaccuracy in mitigating the investment risk creates problems in two manors. The initial forecast of discounted cash flows is also inaccurately projected in periods $t_1 \ldots n$ because of poor exante information. This means that all future payoffs will fall short and suffer from the same forecasting inaccuracies as in period $t_0$. Because of underestimating the initial cash outlay, the firm is forced to infuse the investment with unexpected cash which strains future cash needs for subsequent periods. These two problems combined are likely to leave the firm with cash management problems. Unless they are able to recoup from these inaccuracies over time, a firm will be likely to exit the market. As demonstrated in the case of AT&T Brazil, their cash flow problems resulted in eventual bankruptcy and market exit. Thus, firms with more similar institutional experiences have a greater ability to generate positive expost cash flows than firms with less similar experience. Also, we can assume that the greater the number of similar institutional experiences, the higher propensity for accuracy in risk mitigation in period 1.

**Better Project Selection**

The predictive ability of a firm has residual effects throughout the life of the investment in periods $t_1 \ldots n$. Because firms that have similar prior institutional experience will be accurate in their cash flow predictions, they have a better understanding of which investment projects will have better payoffs than others throughout the life of the investment. Their experience allows them to discern between both the degree of potential risk in each investment and the cash generated from each investment. Because of these combined effects, firms with similar experience are better at selecting foreign investment projects. This factor is key in distinguishing market failures that may have resulted from poor project selection exante entry. Firms with experience have a greater ability to avoid undesirable investment more efficiently because of
their more refined understanding of the institutional environment.

*Less Volatility to Market Fluctuations*

The prior two arguments refer to the effects of exante entry decision making components. The level of accuracy in the predictions will be reflected in the expost performance results. This third component focuses on the firms ability to respond and adapt to unforeseen market fluctuations throughout the life of the investment. For example, many foreign investments are susceptible to higher market risks due to the unpredictability of market shocks such as frequent regulatory shifts, changes in governmental regimes, hyper inflation or currency crises. While firms typically approximate the likelihood of such events, quite frequently it does not safeguard firms from being negatively effected by such events. I posit that firms with similar institutional experience will be more efficient at mitigating risks related to their investments during such market shocks. As a result of having prior knowledge and familiarity with such types of experiences, these firms will experience less volatility to such market fluctuations. Thus, firms with experience should have less deviation from their projected performance than firms with less relevant experience. Lacking experience with extreme market shifts has the potential to derail investment plans for those firms with an inability to mitigate risk in the face of market uncertainties.

These three mechanisms combined allow experienced firms to outperform their competitors.

3. *Empirical setting*
This empirical study examines foreign direct investment patterns into the Brazilian telecommunications industry post deregulation. In 1995, the Brazilian government decided to deregulate many of their public utilities including telecommunications, electricity and oil. This time period represented a major economic shift for the Brazilian government in opening its markets to foreign investment. Under the leadership of Fernando Henrique Cardoso, Brazil underwent a major economic growth plan (Real Plano) to enlist foreign investment and expand the economy. An industry that was predominately state-owned and operated was now open to competition and entry from the global market. I examine the firms that entered the telecommunications industry and track firm performance and failure of the entrants into Brazil. This study is specifically designed to track the propensity to fail given the type of prior experience a firm has from previous foreign investment in host countries prior to Brazil.

Data:

The total number of firms in the telecommunications services industry (including SIC codes 4812, 4813 and 4822) in Brazil is 110 domestic and foreign firms. My sample consists of 70 foreign firms that entered the telecommunications industry in Brazil with local subsidiaries, acquisitions, or joint ventures partners. Data on firm entries and exits in the Brazilian market was obtained through the triangulation of several data sources including the Conselho Administrativo de Defesa Economica (CADE), SDC M&A reporter, CMA Brazil Telecommunications industry reports and the Dunn & Bradstreet Million Dollar Database. The majority (over 80%) of these firms are publicly traded on at least one global stock exchange.

3.2 Methods:
To empirically test my hypotheses, I specify a dynamic analysis hazard rate model to determine the likelihood of two states: 1) a firm’s success or 2) a firm’s exit (divestiture) given their prior experience in various global regulatory environments. This hazard rate function will provide information about the duration that has lapsed, T, between each entry and subsequent exit at a given point in time t. A hazard rate model is very appropriate for this setting and research question because of the necessity to capture the statistical differences between firm success and failure given the type of prior experience they have. The focus of this study is capturing the historical events over the longitudinal time period since deregulation of the Brazilian telecommunications industry to examine what parameters lead to a greater level of firm failure. Thus, the construction of the null hypothesis would infer that there is no statistical difference between firms with prior similar regulatory experience versus not. The hypotheses presented predict a rejection of this claim.

There are two key components of consideration that I want to examine with this model. First, what is the likelihood that a firm will succeed or fail given the events that occur in the Brazilian telecommunications market from 1997 – 2004. And secondly, I am also concerned about how the changes in the covariates across time t effect these success or failure rates. The key feature in any duration model is to measure the length of time, T, that has lapsed (duration) since a firm's entry into the Brazilian telecommunications industry until their exit. This addresses the first component of concern because I am concerned with which firms are more likely to exit. However, to address my later concern of capturing the changes over time that lead to failure, I specify a dynamic analysis hazard rate model as apposed to more static hazard functions because of the ability to capture not only the frequency of firm success and failure, but also the information about the changes leading up to a firm given state, Δt (Carroll, 1983). This
feature of the dynamic analysis model, known as the *transition rate*, gives information about the probability of success or failure given the changes in two points in time, \( t \) and \( t + \Delta t \). The function follows:

\[
\lambda(t) = \lim_{\Delta t \to 0} \frac{\text{Prob}(T \leq t + \Delta t \mid T \geq t)}{\Delta t}
\]

Another concern that requires attention in utilizing hazard rate models is both left-hand and right-hand censoring. Since the market was effectively deregulated beginning in 1997, left hand censoring issues are primarily alleviated because the only firm in existence prior to 1997 was the state owned and operated telecommunications firm, Telebras. However, right-hand censoring could be problematic in interpreting the outcome of what will happen to firms that are in-between states of success and failure. By using a dynamic analysis model, I will have some evidence about the transitional probabilities and the end of the event history (2004) that will give directional but non conclusive evidence about a firm, \( j \).

After conducting this analysis, I expect to find a significant difference in the parameter estimates of accuracy in cash flows, project selection ability and prior experience as it relates to the success and failure rate of firms who have invested in Brazilian telecommunications industry.

**Variables:**

**Dependent variable:**

The dependent variable of focus is simply whether a firm survives or fails since a firm’s entry into the deregulation Brazilian telecommunications industry over the decade 1997-2004. I
measure failure with a binary categorical variable that represents whether a local firm or foreign subsidiary has exited the Brazilian telecommunications industry. I also categorize other possible reasons for market exit (i.e., acquisition, merger, new parent) to ensure that I am not misclassifying any market exits.

**Independent variables:**

**Prior experience:**

For each firm, I am interested in the FDI they have in all country around the world prior to entering Brazil. I am interested to three aspects of their investments including *distance, depth* and *breadth*. The distance measure provides information about the level of similarity in experience a firm has had to the regulatory conditions in Brazil. I first determine what prior countries of investment each firm has entered and second, what is the level of stability of the regulatory environment in these countries of investment. With these two components, I calculate the distance measure which reflects the gap between the firms level of experience in relation to Brazil. To achieve the first components, I examine the Dunn & Bradstreet International Business Location database for 1997 to create a matrix of the FDI operations of each firm, j, in each country, k. To achieve the second component, I develop a composite regulatory index for each country in a matrix by utilizing data from the World Bank International Directory of Utility Regulatory Institutions reflective of 6 measures (number of telecom regulatory agencies, relation to government, size, ability to enforce and create laws). To determine the level of regulatory prior experience for each firm j, I compare each firms type of regulatory experience with that of Brazil by assigning a numerical code.
To understand the amount of prior experience of each type, I also create a frequency variable, depth, which denotes the number of prior experiences a firm has in each type of regulatory environment. Also, I create a breadth variable to capture the range of types of experiences.

**Accuracy in Generating Cash Flows:**

I examine create a measure of the accuracy between the firms ex ante cash flow predictions versus the expost actual performance results. I utilize publicly available data form the Brazilian telecommunications regulatory agency to captured ex ante cash flow prediction that was provided as part of the privatization licensing process. I utilize in country data for each firms net cash flows reported by Conselho Administrativo de Defesa Economica (CADE).

**Better Project Selection:**

To examine the project selection efficiency of each firm, I use the firm payback period for the investment represented by:

\[
\text{Payback period} = \# \text{ of years to a positive cash flow} = \\
\# \text{ of years with } (-) \text{ NCF} + \left| \text{cash flow in that year} \right| / \text{CF of subsequent year}
\]

**Risk Mitigation through uncertainty:**

I measures a firms ability to manage market volatility as the ex ante – ex post quarterly earnings projections after each environmental shift including

a) Regulatory change
b) Presidency change
c) Currency devaluation
d) Inflationary spikes

**Control variables:**
I also take into account a variety of control variables that may influence the survival or failure rate of a given firm's FDI into the Brazilian telecommunications industry. For example, Li (1995) found statistical significance as a result of including firm size and age into their model of failure rates of FDI entry. I include controls for firm level variation including: firm size, of both the parent company and subsidiary as measured by the number of employees, firm age and subsidiary age. Also, I include industry level controls for industry growth rate and industry concentration to capture and natural fall out more related to the competitive pressures of the market or the lifecycle stages of the market dynamics.
TABLE 1
Literature Review of the Effects of Prior Experience on Subsequent FDI Decisions
<table>
<thead>
<tr>
<th>Literature</th>
<th>Type of Prior Experience</th>
<th>Change in Strategic Decisions</th>
<th>Improved Performance</th>
<th>Empirically tested</th>
</tr>
</thead>
<tbody>
<tr>
<td>Johanson &amp; Vahlne (1977)</td>
<td>Increasing general knowledge of foreign markets and gradual investment changes</td>
<td>Reduce the risk of uncertainty and increases level of foreign market commitment</td>
<td>No conjectured impact of firm performance</td>
<td>No; Theoretical</td>
</tr>
<tr>
<td>Davidson (1980)</td>
<td>Inexperience firms prefer similar markets; Firms prefer investment in markets with prior experience.</td>
<td>More experience reduces the risk of uncertainty and shifts preferences away from similar countries</td>
<td>No evidence on the impact of firm performance</td>
<td>Yes; preference s only; no direct risk measures used</td>
</tr>
<tr>
<td>Kogut &amp; Singh (1988)</td>
<td>Cultural distance from the host country effects entry mode strategic decision</td>
<td>Uncertainty leads to leads to more JV and greenfield investment instead of acquisition</td>
<td>Yes; but risk assumed in entry mode decision</td>
<td>No evidence on the impact of firm performance</td>
</tr>
<tr>
<td>Benito &amp; Gripsrud (1992)</td>
<td>Cultural similarity is not necessarily a predictor of first time FDI entry; Alternatively, firms’ with more experience to do not gravitate towards cultural distance over time</td>
<td>Risk relationships of cultural distance and FDI are not fully explained</td>
<td>Yes</td>
<td>No evidence on the impact of firm performance</td>
</tr>
<tr>
<td>Erramilli (1991)</td>
<td>Service firms type of experience with a host countries culture (cultural distance)</td>
<td>Effects entry mode strategic decision</td>
<td>No evidence on the impact of firm performance</td>
<td>No evidence on the impact of firm performance</td>
</tr>
<tr>
<td>Li (1995)</td>
<td>1) Diversification experience 2) entry mode experience and 3) the number of prior investments</td>
<td></td>
<td>Measures firm success or failure dependent on the level of experience</td>
<td>Yes</td>
</tr>
<tr>
<td>Shaver ,Mitchell &amp; Yeung (1997)</td>
<td>Firms’ with FDI experience in a country are more likely to survive versus firms with no experience; Survival in enhance given other foreign firms’ market presence</td>
<td>Accuracy of risk mitigation</td>
<td>Improves survival rate</td>
<td>Yes</td>
</tr>
<tr>
<td>Luo &amp; Peng (1999)</td>
<td>Experience is a function of both diversity (breadth of business operations) and intensity (age of operations) in a host country; experience = knowledge</td>
<td>Knowledge improves efficiency in operations and increases ability to exploit resources</td>
<td>Generally, experience leads to better performance as measured by key financial indicators; Firms with experience have better performance in instable environments</td>
<td>Yes</td>
</tr>
</tbody>
</table>
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