

Do firms internationalize because they are profitable or are firms profitable because they internationalize? Assessing the causality between internationalization and profitability in new ventures

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Abstract

International business (IB) theories, including the Uppsala model and the International Entrepreneurship (IE) perspective, have provided explanations linking the level of the firm's international commitment to organizational performance and found a non-linear relationship. However, causality in that relationship is still a veiled story. The aim of this study is to explore how the organizational age at the time of the first international market entry can change the direction of causality in the binomial internationalization-profitability. We add arguments based upon on the earliness of internationalization (how soon after inception a venture becomes an international player) to suggest a more complex relationship in which financial performance provides feedback on the implementation of internationalization strategies in the form of resources, particularly in firms that start internationalizing at a later stage. This feedback generates both the knowledge and the slack resources needed to support an adaptive feedback during the post-internationalization process. Using the most up-to-date technique in structural equation modeling for testing causality, we performed a multigroup analysis investigating the long-term rather than short-term causal associations between international commitment and profitability in a longitudinal data set of 1,258 new ventures over five years of post-internationalization. Our findings showed that past profits positively contribute to future internationalization attempts in late internationals, but neither that causality nor the reverse were proven for early internationalizing firms. This cross-lagged evidence, therefore, supports the need to extend IB theories by considering financial performance as an antecedent and not just an outcome of the degree of internationalization.

Keywords: international commitment; earliness of internationalization; profitability; causality; reverse causality; cross-lagged panel model; SMOPEC.