FINANCIAL PERFORMANCE OF FIRMS IN INTERNATIONAL MARKETS: THE IMPACT OF THE LOCUS OF DESTINATION

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Abstract

This research envisages a new approach of the impact of internationalisation on the economic and financial performance of companies from a geographical point of view through an innovative regional model. This approach is based, both, on a review of literature and on econometric analyses of a sample of listed medium-sized American and European service sector companies. It suggests that the diptych "locus of origin - locus of destination" is essential in order to improve the understanding of complex corporate internationalization processes. The results are discussed in relation to major issues concerning the performance of companies expanding internationally and refer to a framework of international indexes applying to financial performance.

Key words

Internationalization

Firm performance

Business services

Financial markets

Regional strategy

Introduction

The internationalization of companies is a complex process that can be largely explained by the increase in the number of loci of destination both in terms of exchange and investment flows. In effect, within the framework of internationalization, companies cannot base their choices solely on their own strong points; they must also take into consideration the respective attractiveness of potential loci of destination so that they can more intelligently select them and more efficiently exploit their strengths with a view to improving performance. Taking into account the diptych "locus of origin/locus of destination" is therefore an important factor in the analysis of the international performance of companies.

While it is true that the impact of geographical diversification on the economic and financial performance of companies has been widely studied in the academic literature. research has, up until now, concentrated on the link between the degree of internationalization, most frequently measured in terms of the percentage of turnover achieved outside the country of origin, and the performance of companies measured in terms of a global indicator (for example, the operating margin or return on invested assets). Research has, moreover, focused exclusively on large companies in the industrial sector. But, even more tellingly, if the literature has copiously described the impact of internationalization on the economic and financial performance of companies, the influence of the geographical locus, both in terms of the locus of origin and the locus of destination, has never been really never been looked at.

This article is the first to envisage the impact of the relationship between loci of origin and loci of destination on international performance. In utilizing measurements of performance comparable to those used in academic research, it studies the average values of the service sector, which tends to constitute the essential sector in modern economies.

The first part of the article presents a synthesis of the literature on the internationalization of companies. The second part is dedicated to the specificities of the service sector. The third section attempts to justify the geographical approach in underlining the originality of the model. The fourth part of the article presents the results obtained. Lastly, the article concludes by outlining the limits of the results and indicating potential new research directions.

1. The major theoretical approaches to the internationalization of companies

Work on the internationalization of companies, the factors stimulating it, the processes which characterize it and the obstacles which it encounters can be categorized into five major theoretical currents.

The international trade theory school (*FDI theory*) initiated by Smith (1776) and Ricardo (1817) and brought up to date by Hecksern Ohlin and Samuelson (1949) has inspired a great deal of research into the international lifecycle of products (Vernon, 1966). This current later gave rise to transaction cost theories (Williamson, 1975) and Dunning's eclectic theory (1980).

The stage theory school initiated by Cyert and March (1963) laid the groundwork for the development of Johanson and Vahlne's U-model (1977), which was followed by innovation models elaborated, notably, by Cavusgil (1980, 1984) and Bickley and Tesar (1977).

More recently, the network perspective proposed by Johasson and Mattson (1978) has been used in research into the internationalization of smaller or more recently established companies.

Using Penrose's resource-based theory (1959), Wernerfelt (1984), Hamel and Prahalad (1990) and Teece, Pisan and Shen (1997) developed theories focusing on the resources, fundamental competencies and dynamic capacities of firms.

Lastly, the more financially-oriented portfolio theories such as that of Markowitz (1952) have also been used to explain the motivations behind the internationalization of companies and the choices between various possibilities that they inspire.

These theoretical currents have highlighted the advantages and limits of corporate internationalization.

1.1 The advantages of corporate internationalization

Amongst the numerous advantages sought in the process of internationalization are reduction in costs, access to new technologies, risk-sharing (through partnerships) and profits deriving from setting up operations in promising economic zones.

1.1.1. Caves (1971), Johanson and Vahlne (1997), Porter (1985) and Grant (1987) have highlighted economies of scale as one of the advantages of internationalization. Buckley and Casson (1976) have underlined the usefulness of exploiting market imperfections by means of the use, outside the country of origin, of intangible assets.

1.1.2. Moreover, in reference to Dunning's OLI theory, linked to the phase theory proposed by Lemaire (1997), which focuses particularly on the passage from one phase to another, lower costs, for example, can serve as a justification for the passage from initial internationalization (Phase 1) to local

development (Phase 2) and multi-nationalization (Phase 3); it transpires that one of the main advantages of internationalization is the low level of costs in certain zones.

1.1.3. In this perspective, some scholars have emphasized the capacity to share central and common functional tasks between several countries – Research & Development for Tallman and Li (1996); marketing for Campbell and Verbeke (2003) – as well as the coordination and complementarity of resources as a driver of internationalization.

1.1.4. The Upsala model of internationalization (Johanson and Wiedersheim-Paul, 1975; Johanson and Vahlne, 1977) supposes that a lack of knowledge of international markets can act as a barrier to internationalization (Fosgren, 2000). By striking up a partnership with a local firm, an international company can not only benefit from its partner's expertise but also develop, at a lower cost, an improved knowledge of the locus of destination. It would be symmetrically in a position to exploit sources of competitive advantage to which domestic companies did not have access (Fayerweather, 1978). Lastly, foreign subsidiaries can contribute to improving the knowledge-base, capacities and competitiveness of their parent companies (Delios and Henisz, 2000; Zahra, Ireland and Hitt, 2000).

1.1.5. If the acquisition of new technologies is a prerequisite for expansion, the development of such technologies is equally indispensable. Since at the present time, technology matures very rapidly, companies are increasingly exposed to competition. They have to re-utilize the advantages of which they dispose in order to develop a continuous flow of new innovations. In seeking expertise abroad, companies guarantee their internal development and thereby increase their growth opportunities. Moreover, internationalization enables them to increase revenue and more efficiently distribute risk, thus rendering themselves less exposed.

1.1.6. The existing literature highlights the potential for reducing risk via geographical diversification (Lessard, 1983; Fatemi, 1984). Structurally, risk can be broke down into diversifiable or non-systematic risk (associated with random events specific to the firm) and systematic risk (for example, inflation or recession, which affect most companies). In an international perspective, instead of depending entirely on one country (the country of origin), companies can reduce their level of exposure to risk by operating in other locations (Kim, Hwang and Burgers, 1993). The greater the geographical scope of their activities, the more they can spread their costs and revenues amongst various markets (Hennart, 1982), thereby reducing unwelcome fluctuations (Kim, Hwang and Burgers, 1993). Recent empirical studies indicate that multinational companies diversify geographically and industrially with

the objective of obtaining an optimal combination of costs and revenues (Geringer, Beamish and daCosta, 1989; Kim, Hwang and Burgers, 1993; Sambharya, 1995).

1.1.7. Lastly, the advantage of internationalization is linked to the attractiveness of certain territories, a term which recently appeared with the increased interest in zones of destination. "Attractiveness" has been defined (AFII, 2004) as the capacity to attract and retain the best talent (scientific talent, for example), firms, and capital, as well as strategic activities (Research & Development, head offices, etc.). The notion of attractiveness applies to both territories and sectors of activity.

1.2 The costs of internationalization

Within the framework of their growth process as well as their process of internationalization, companies are obliged to meet a certain number of costs, the most important of which are transaction costs, agency costs and costs associated with political and financial risks.

1.2.1. Following on from the work of Williamson, the analysis of transaction costs (Buckley and Casson, 1976) is one of the major approaches to internationalization. Transaction costs include expenditure required to obtain information, and to negotiate and guarantee the smooth functioning of contracts. The specificity of assets, the frequency of economic exchanges, and the level of uncertainty are the determining factors. Due to geographical and cultural diversity, transaction costs increase as companies become more internationalized. According to Johanson and Vahlne (1977), internationalization is a learning process which manifests itself in a continual quest for information which implies additional costs. Numerous authors mention problems associated with communication and coordination (Jones & Hill, 1988; Hofstede, 1980), with government (Hitt, 1997; Tallman & Li, 1996), and with motivation, all problems that can be attributed to the cultural distance between countries of origin and countries of destination. Some of these concepts are integrated into transaction costs (Jones & Hill, 1988) or agency costs (Doukas & Travlos, 1988; Roth & O'Donnell, 1996).

1.2.2. The main organizational concerns of international companies vis-à-vis their subsidiaries and foreign partners are coordination and control, which translate into "agency costs" or characteristics of an "agency relationship." Within the framework of internationalization, these agency costs[4], generated by partnerships with foreign companies or by acquisitions, include costs associated with the integration

[4] The most classic definition of an agency relationship is provided by Jensen and Meckling in a 1976 article: "We define an agency relationship as a contract via which one (or more) persons (the principle) hires another person (the agent) to execute in their name a task of whatever description which implies the delegation of a certain power of decision to the agent. The existence of a conflict of interests between the partners is one of the main problems addressed by the theory of agency."

and monitoring of a certain number of parameters such as managerial practices, administrative structures and the procedures and culture of companies that have been acquired. In order to manage subsidiaries as effectively as possible and guarantee the transfer of knowledge, multinational companies must use suitable control mechanisms and more complex organizational structures. Operational costs and agency costs increase as internationalization progresses, as various studies have shown (Hitt & al., 1997; Jones & Hill, 1988; Donnel, 1996). Wright, Madura and Wiant (1997) mention four factors explaining why agency costs increase in line with the degree of internationalization: the geographical dispersion of subsidiaries; the difference in company culture between subsidiaries; differences in language and culture; and the level of economic development of the host countries.

1.2.3. Political and financial risks are considered external costs. Political uncertainty increases when foreign governments make unanticipated changes to the business environment. Political risk includes, amongst other things, boycotts and expropriations effected by the governments of host countries (Boddewyn, 1988). On a more operational level, that of insurance institutions such as Coface, political risk covers civil war, war with foreign powers, brutal regime change, and the risk of transfer problems. Reeb, Kwok and Baek (1998) mention inflation and variations in exchange rates as the main factors in financial risk. According to Rub (1998), political and financial risks affect results linked to internationalization.

1.3 The links between the degree of internationalization and the overall performance

The link between international expansion and company performance is difficult to establish in that it derives from the permanent and evolutive comparison of the advantages and limits of internationalization described above. Depending on periods, samples and methods of analysis, recent empirical studies have defined three types of relationships between internationalization and performance: linear, U-shaped, and S-shaped.

In recent theoretical studies, Riahi and Belkaoui (1998), Contractor (2003), and Lu and Beamish (2004) attempt to reconcile research results by suggesting that a horizontal S-shaped curve should be considered universally applicable to the relationship between performance and internationalization.

- In the first stage of internationalization, the total cost, made up of three variables – costs linked to the foreign markets, costs associated with novelty, and coordination costs – is superior to the total profits associated with internationalization.
- In the second stage, profits outstrip costs and the company generates a net profit substantially superior to 0.

- In the third stage, with a very pronounced degree of internationalization, coordination costs continue to rise while profits decline. Due to this phenomenon, companies no longer generate a net profit and performance decreases as the degree of internationalization increases.

2. The specificities of the service sector

Even though it plays a major and growing role in modern economies, accounting for over 60% (and sometimes over 70%) of total economic activity in a large majority of OECD countries, the service sector has, up until now, been the object of only a very small number of empirical studies. Moreover, this trend is set to become yet more pronounced due to the growing pressures on companies to focus on key competencies while at the same time reducing production costs, pressures which encourage the development of sub-contracting.

2.1. The application of theories developed for industry to service sector companies

The five current theories describing internationalization derive from observations about companies most of which are American and all of which are active in the industrial sector. Numerous authors, including Boddewyn (1986), Dunning (1989), Li and Guisinger (1992), Campbell and Verbeke (1994), Douglas and Graig (1995), Goodnow (1985), and Aggrawal and Ramaswamy (1992) conclude that these theories can be applied to the service sector. However, Erramili (1990), Ekeldo and Sivakumar (1998), Erramili and Rao (1993) and Contractor and Kundu (1998) have demonstrated that the specificities of service companies (different approaches to modes of entry, for example) have a major impact on the link between internationalization and performance.

2.2. The impact of the specificities of service sector companies on the shape of the link between internationalization and performance

Services constitute a diversified group of economic activities not directly associated with the production of goods, raw materials or agricultural products. They imply human intervention in the form of work, consulting, and managerial, training and mediation competencies. The literature has emphasized a certain number of characteristics specific to services.

● Services are intangible (Bateson, 1977; Berry, 1980; Buckley & Prescott, 1992; Berthon, 1999).
● They present a characteristic of inseparability (de Bandl and Gadrey, 1994; de Bandt, 1995). Direct contact with clients and a knowledge of the local culture are indissociable from the service provided (Ekeledo & Sivakumar, 2004). This interaction between service companies and their clients requires

the presence of two parties at the same time and in the same place (the principle of "uno actu"). This is what Bhagwati (1994) calls "embodied services" (non-separable services). Internationalization is thus only possible if the service company is present in the territory of the client (by travelling there on a regular basis, by setting up an office *in situ*, or by means of local agents) or if the client sets up an office in the premises of the service company. Disembodied services are said to exist if a medium can be used to export and import the service. This characteristic of disembodiedness has an important influence on the mode of entry (Ekeledo & Sivakumar, 1998) and, therefore, on the shape of the link between internationalization and performance.

● Services require the participation of the client (Ochel, 2002). In consulting companies, for example, it is necessary to define client needs before providing the service and it is often desirable to closely associate the service provider with their client while the recommendations of the consulting company are being implemented.

● Services are perishable (Berry, 1975; Lovelock, 1981; Buckley & Precott, 1992; Berthon, 1999).

● The quality of service is difficult to control (Kotler, 1997; Lovelock, 2001). This characteristic, which is of particular importance to clients, is related to the *ex ante* uncertainty concerning the quality of service expressed in terms of *"how well the production of the service and its result meet customer expectations"*. Unlike a good, a service can neither be examined nor tested before use. Clients are, in general, insufficiently informed about the quality of the service. In order to eliminate or reduce client risk and to convince clients of the quality of their offer, service companies implement strategies based on quality guarantees and brand marketing.

● The service sector is highly heterogeneous (Langeard *et al.*, 1981; Buckley & Prescott, 1992; Berthon, 1999). The sector includes companies of every size; it includes a wide diversity of economic models (capitalistic or otherwise) and degrees of mobilization of the human factor.

2.3. A little studied sector

The service sector has been the object of very few studies on the part of academic scholars, whose work has essentially focused on industrial companies. Thanks to an analysis of the work of Osegowitsch and Zalan (2005) concentrating on, respectively, 62 and 39 research articles exploring the link between internationalization and company performance, we were able to establish that studies were predominantly built around on American companies, manufacturing firms and large companies.

- *Insert table 1 and table 2* -

3. The contribution of the geographical approach to the originality of our model

3.1. An almost non-existent literature on geographical performance

Recent research has established the importance of the locus of origin in the analysis of the link between geographical diversification and financial performance (Wan & Hoskisson, 2003). Rugman and Verbeke (2004) insist particularly on the importance of the locus of destination. For these authors, an analysis of sales in the three major zones should be used to demonstrate that the relative percentage of sales in the locus of destination compared to the locus of origin is a critical performance parameter. For Rugman and Verbeke, the disappointing and contradictory results of previous research on the link between diversification and performance can be explained, at least partially, by:

- the lack of data on the locus of destination
- the fact that successes measured in terms of the capture of market share in the locus of destination can adversely effect economic performance

Tugman and Verbeke (2004) recommend that research into the impact of geographical diversification should focus on the regional aspect and the scope of multinational companies' sales.

3.2. Geographical accounting norms

The IAS 14 and FAS 131 norms governing the presentation of sectorial information oblige all companies quoted on the stock exchange to publish geographical information as soon as the following conditions apply:

- If products from sales to external clients and transactions with other sectors account for at least 10% of total products, both external and internal, in all sectors.
- If the firm's sectorial result (profit or loss) represents at least 10% of the cumulative result of all the profitable sectors or of the cumulative result of all the sectors making a loss, whatever the largest of them in terms of absolute value.
- Lastly, if these assets account for at least 10% of the total of assets in all sectors.

A detailed analysis reveals that the sectorial norms IAS 14 and FAS 131 share many of the objectives, modes of calculation, and approaches to geographical accounting applied to companies both in Europe and the United States. This meant that we were able to include firms from both the European and North American continents in our sample.

3.3. An original model

All previous empirical and theoretical studies have emphasized the relationship between the degree of internationalization and performance. Following on from these results, we have focused our research on the link between internationalization and company performance in a geographical perspective. It seems, in effect, that within the framework of internationalization, companies can no longer rely merely on their resources and advantages to guarantee success; they must also take into consideration the particularities and attractions of their chosen loci of destination in order to exploit their strengths and attain the highest levels of performance possible.
That is why we have based our model on regional performance, taking into account the locus of destination in which companies are established.

Our model is constructed around two main hypotheses:

- H1: The relationship between internationalization and performance is non-linear and manifests itself in the form of a sygmoid (a horizontal "S").
- H2: The couple "locus of origin/locus of destination" is a determining factor in the formation of the link between internationalization and company performance.

3.4. Methodology

3.4.1. The sample

Our sample is composed of nearly two hundred quoted companies from Europe and America. It was constituted using DJ Stoxx indices which use the Industry Classification Benchmark and cover the European and North American loci of origin.
We selected service companies belonging to four super-sectors of the DJ Stoxx classification:

- The finance sector (including banks, insurance companies and financial services)
- The cyclical goods and services sector (leisure, media, etc.)
- The non-cyclical goods and services sector (distribution, public services, etc.)
- The technology sector (IT software, IT service companies, the internet sector, and telecommunications operators).

- *Insert here table 3* -

3.4.2. Data

Our database, on which this research is based, was built up from the annual reports of quoted companies. We used information from stock markets as well as financial and economic information on the companies in our sample and the countries of destination, using data from JCF Quant, IMD Lausanne and articles published by A.T. Kearney on attractiveness. Data on companies derives from accounting and financial information from consolidated accounts for the period between 2000 and 2004.

They include:

- Total turnover and turnover by locus of destination
- Total operating income and operating income by locus of destination
- Total assets invested and assets invested by locus of destination
- Consolidated goodwill on the assets side
- Total net financial debt (or, in other words, total consolidated financial debt minus the consolidated cash flow on the assets side)
- Total consolidated own funds
- Number of shares
- Net assets per share

3.4.3. Variables

In order to measure corporate performance we took into account indicators based on published accounts, including operating margin and return on assets. These measurements are accepted as financial performance indicators and are immune to managerial manipulations. They have been used in a substantial number of studies (Lu & Beamish, 2004; Ruigrok & Warner, 2004); Thomas & Eden, 2004; Wan & Hoskisson, 2003, etc.) because they are well suited to comparisons between different countries.

The relationship between internationalization and regional performance is presented as follows in our model:

$$Performanc\ e\ Z_j = a_1 + (a_2 \times DOI\ \ Z_j) + (a_3 \times DOI\ \ Z_j^{\,2}) + (a_4 \times DOI\ \ Z_j^{\,3})$$
$$+ (b \times A_j \times \frac{CA\ Z_j}{CA\ Z_O}) + (c_1 \times X_1) + (c_2 \times X_2) + (c_3 \times X_3)$$

For our regional performance model, company performance in **Zone Zj (Performance Zj)** is measured using two variables:

1) Either using the **"OM Zj"** or, in other words, the operating margin calculated as the ratio between the trading profit generated in locus of destination j on sales achieved in locus of destination j.
2) Or using the **"ROA Zj"**, or, in other words, return on assets calculated as the ratio between the trading profit in the locus of destination j on assets invested in the locus of destination j.

The independent variable selected – "DOI Zj" (degree of internationalization in zone j) – is measured by the ratio of sales (or turnover) achieved in Zone j to the total sales (or total turnover) of the firm, or, in other words, CA Zj (Turnover Zj) / CA total (Total Turnover). This is the approach most frequently used in studies on internationalization (Sullivan, 1994a and 1996; Qian et al., 2003; Shenkar & Luo, 2001; Rugman & Verbeke, 2004; Ruigrok, Wagner & Amman, 2004; Daniels & Bracker, 1989; Geringer, Beamish & daCosta, 1989; Stopford & Dunning, 1983).

Lastly, we controlled a certain number of variables able to influence company performance in the international sphere: the "goodwill/fixed assets" relationship, termed X_1, the "financial debt/own funds" relationship, termed X_2, the "share price/net assets per share" relationship, termed X_3, and the variable measuring the attractiveness of the locus of destination, termed A_j.

● The "goodwill[5] /fixed assets" relationship: In service companies, goodwill represents the largest part of the firm's intangible assets; it includes a certain number of parameters specific to the firm such as the quality of human resources, the existence of good relations with clients, and a good reputation, all of which are vitally important factors for service companies.

● The "financial debt/own funds" relationship: According to Eitman, Stonehill and Moffett (2001), Madura (2000) and Shapiro (1991), by reducing operational risk, international diversification increase firms leverage capacity[6].

● The "share price/net assets per share" relationship: This ratio gives an indication of the estimated value of firms on the financial markets. According to Dong, Hirshelifer, Richardson and Teoh (2006), the "share price/net assets per share" ratio is an indicator of the capacity of firms to generate high levels of return on investment. This ratio is therefore used as an indicator of future growth and of managerial

[5] Goodwill represents the overall excess value of a firm at a given date vis-à-vis the correct value attributed to its identifiable assets.
[6] Leverage is measured by means of the ratio between the "book value of long-term debts" and "book value of own funds".

efficiency. We have thus selected this ratio in order to measure anticipated growth predicted by financial analysts and investors.

● The variable measuring the attractiveness of the locus of destination j, termed A_j. The attractiveness of Zone j for company I, Ai,j, is an indicator that takes into account the attractiveness of Zone j compared to the locus of origin and total investment made by the firm in Zone j.

3.4.4. Testing the hypotheses

3.4.4.1. Testing H1

In order to test our first hypothesis – that "the relationship between 'internationalization and performance' is non-linear and manifests itself in a sigmoid shape (a horizontal 'S')" – we employed the "average over five years" method, using SPSS econometric software. For each of the diptychs "locus of origin/locus of destination", we analyzed the following factors: the level of R^2; the analysis of the variance explained by the model; and the degree of significance of the coefficients associated with the degree of internationalization.

In order to avoid overly complicating our exposé, we will only present results for the diptych "Europe/Europe" presented in Table 5 below. The level of R^2 obtained for this regression is low (around 13%) and this result is largely confirmed by an analysis of the variance. The R^2 is slightly higher for this cubic model (22%), which leads us to think that the cubic model has a greater explanatory power than the two other models. Moreover, this result conforms to our expectations and to our analysis of the empirical literature. The coefficient of **DOI and DOI^3** is positive and the coefficient of **DOI^2** is negative. Contractor, Kundu and Hsu (2003) obtain absolutely identical results for their total sample, with, however, a substantially more significant R^2. In this case, the three coefficients of the regression are significant to a threshold of 5%.

The results obtained by using the "average over five years" method thus confirm our initial hypothesis. For the other five diptychs "locus of origin/locus of destination", we reached the same conclusions, namely that the cubic model is the most effective.

3.4.4.2 Testing H2

Taking these results into account, we selected the cubic model for use in our continuing research. In order to test our second hypothesis – that "the diptych "locus of origin/locus of destination" is a determining factor on the formation of the link between internationalization and performance" – we employed the "panel data" method, using Eviews econometric software. For each of the diptychs "locus of origin/locus of destination", we analyzed the following factors: the normality of the residues;

the auto-correlation of the residues; the heteroscedasticity of the data; the choice between a fixed-effects model and a variable-effects model.

The results we obtained for the regional model were substantially more satisfactory. Furthermore, the Hausman test encouraged us to select the individual fixed-effects model in conformity to the most recent work in this field of research.

Results obtained via the "panel data" method for the six "loci of origin/loci of destination" diptychs are presented in Tables 6 and 7. The level of $\mathbf{R^{2\ plural}}$ obtained are presented in Tables 6 and 7. The level of $\mathbf{R^{2\ plural}}$ obtained for these regressions conform to work of this type.

4. Results and discussion

Presentation of the results

In this section we analyze the results concerning the degree of internationalization (DOI) and performance (MO and RAI) selected for the six major cases of the regional model (different locus of origin and locus of destination).

We traced the shapes of the relationship between performance and internationalization for each of the locus of origin/locus of destination cases based on the econometric results of the various regressions (for the operating margin and return on assets**)** generated in the "panel data" econometric method. The data are presented in Tables 6 and 7.

In the European locus of origin, the results of the three loci of destination conform to our anticipations, to the work of Contractor, Kundu and Hsu (for "knowledge intensive" companies in the three loci of destination), and to that of Capar and Kotabe in regard to the U-shape at the beginning of the internationalization process.

In effect, during the course of the first phase and with the passing of time, firms are able to learn how to significantly minimize costs associated with international expansion (Capar & Kotabe, 2003; Eden & Thomas, 2002; Ruigrok & Wagner, 2003; Lu & Beamish, 2001). At the outset of the internationalization process, costs outstrip profits until such time as firms accumulate experience and learn how to control them. Contractor and Kundu (2003) refer to Type 1 Costs, which cover fixed and moderate costs for low degrees of internationalization (DOI) ("liabilities of foreignness and newness, a lack of familiarity with local laws, consumer ethnocentricity, consumer taste specificities, problems of

inter-cultural communication). This phase of decline in performance is followed by an upturn phase, a phenomenon observed for the three loci of destination for the European firms, and for the European locus of destination for American firms. Our results conform to the literature on these four diptychs.

As internationalization gathers pace, firms deploy competencies and resources already developed in their domestic markets to achieve economies of scale and pursue the process of internationalization without being subject to substantially increased costs (Gomes & Ramaswamy, 1999). Consequently, the benefits of internationalization outstrip incremental costs. Nevertheless, as internationalization gathers pace, coordination and control costs increase exponentially and become difficult to sustain in spite of the progress firms make in terms of organizational learning. Consequently there is a threshold of internationalization that firms should not go beyond. Contractor and Kundu (2003) term these continual and exponential costs for high degrees of internationalization, which include coordination and control costs due to the complexity, uncertainty and dynamism of the markets, Type 2 Costs.

Lastly, we observed, in line with our expectations, a decrease in performance levels for the three loci of destination for European firms, and for the European locus of destination for American firms.

According to our analysis of the gradients and the levels of the points of inflection, it transpires that for mid-sized European service companies, expansion in Europe or North America is equivalent.

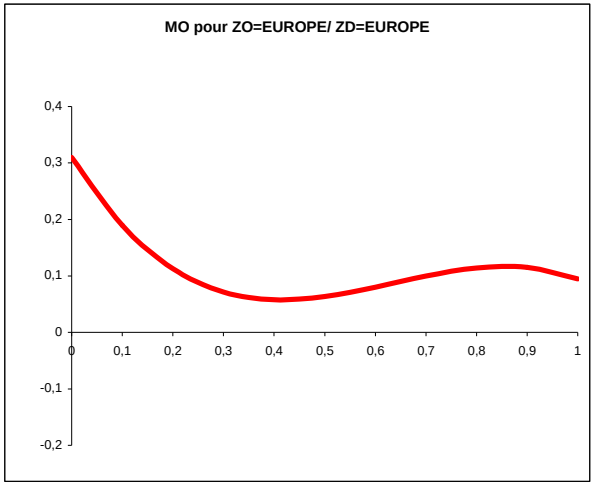
Within the North American locus of origin, the results for the three loci of destination conform to our expectations, except for the Rest of the World, results for which conform to Contractor, Kundu and Hsu (for “knowledge intensive” companies for the European locus of destination and for “capital intensive” companies for the Rest of the World), and to Capar and Kotabe in terms of the U-shape characterizing the initial phase of internationalization.

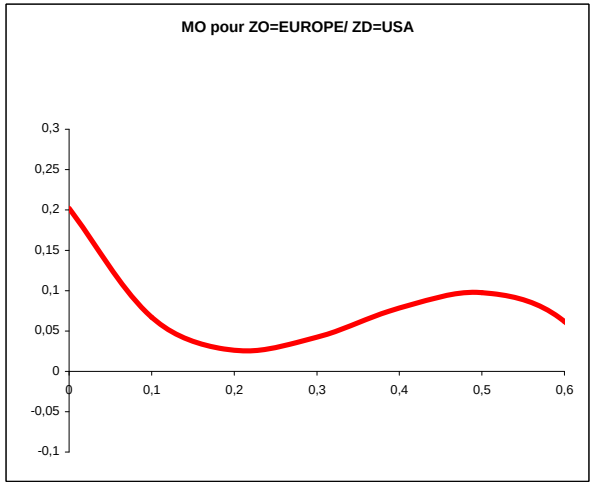
On the other hand, the analysis of gradients and the level of points of inflection for mid-sized American service companies reveals that developing in Europe and developing in North America are two very different propositions.

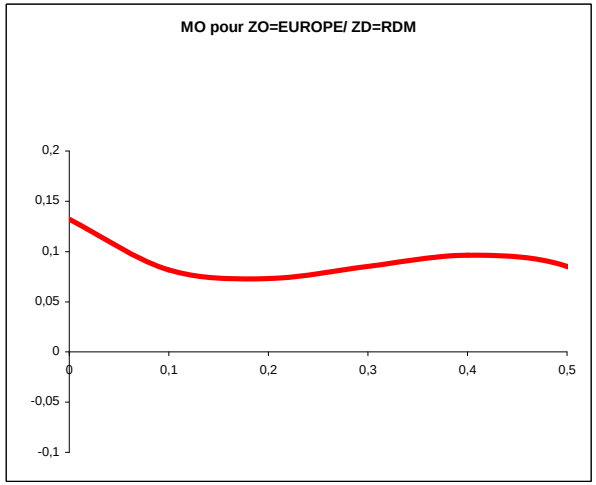
Lastly, our analysis of the Rest of the World locus of destination produces results which conform to the literature. In effect, Johansson and Yip (1994), and Williamson (1997) demonstrate that American firms initially expand into culturally proximate (geographically close) countries, while, on the other hand, Ruigrok and Wagner (2003) show that German firms initially expand into culturally distant

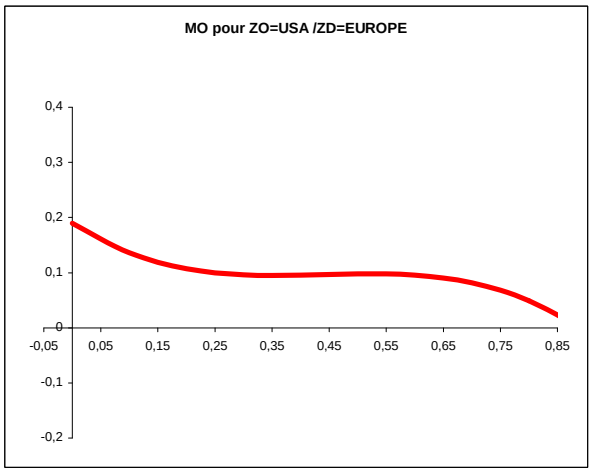
countries for reasons of market size. That makes it possible to explain the shape of the curves for the European locus of origin and for the North American locus of origin. Unlike the performance of American firms, that of European companies declines in the Rest of the World as they expand into culturally more distant countries.

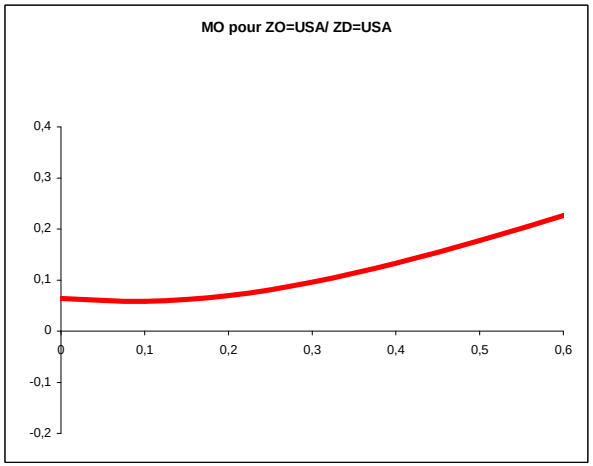
Shape of the curve linking performance (operating margin) and internationalization for each of the six locus of origin/locus of destination diptychs

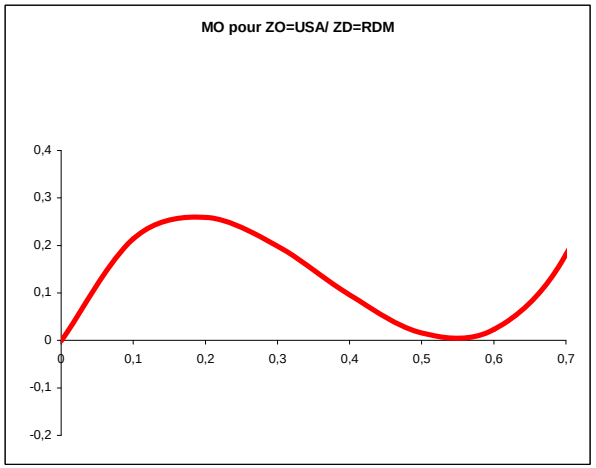












5-Conclusion

Our empirical research falls into the academic field of the study of the international performance of service companies. Two recent studies have focused on service companies. 1/ Capar and Kotabe (2003) present the hypothesis of a U-shaped curve and their empirical results confirm the existence of a quadratic link between internationalization and company performance. 2/ Contractor, Kundu and Hsu (2003) present the hypothesis of an S-shaped curve and their empirical results confirm the existence of a cubic link between internationalization and company performance. Contractor, Kundu and Hsu posit a "heterogeneity" of results and empirical coefficients. Our research confirms the complexity of these situations. Our results conform to the existing empirical literature both in terms of value, sign and significance of regression coefficients and in terms of quality of regressions. Nevertheless, our research provides a specific contribution to the academic field since it is the only work of its kind that has, up until now, taken into account the geographical dimension in the analysis of the link between performance and internationalization. Our research leads to the conclusion that the link between performance and internationalization is context dependent, not only in terms of locus of origin but also in terms of locus of destination.

The limits of our research are as follows: 1/ a period of study of only five years, 2/ the number and origin of the firms (only a hundred or so firms from Europe and North America), 3/ the size of the three loci of destination, 4/ the number of indicators used (a single measure of internationalization and just two measures of company performance). Consequently, the field of academic research could be enlarged 1/ by increasing the number of criteria used (non-financial criteria concerning company governance, social and environmental aspects, and financial criteria such as the number of subsidiaries, the date the foreign subsidiaries were set up, the mode of entry into target markets, 2/ by more closely studying the characteristics of attractiveness and integration associated with "psychic" distance and geographical distance; 4/ by extending the study to other service sectors; by extending the study to non-quoted SMEs; 6/ by including a comparison with large firms quoted on the stock exchange; and, 7/ by carrying out longitudinal clinical studies on a number of service companies characterized by specific problematics.

Internationalization is a complex process: the multiplication of loci of destination has made choices difficult; the study of these loci has become vital and can even condition the eventual

success or failure of investments. Thus, within the framework of internationalization, companies cannot base their strategy exclusively on their own strengths but must take into consideration the respective points of attraction of various loci of destination in order to select and exploit them more effectively, thereby improving their performance. Consequently, taking into account the diptych "locus of origin/locus of destination" seems to be an important factor in the analysis of the international performance of companies.

6-Bibliography

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Table 1: Percentage of empirical studies by geographical origin of company

Origin of companies	American companies	European companies	Companies from the rest of the world
Relative percentage of studies	66 %	14 %	20 %

Source: authors' survey.

Table 2: Percentage of empirical studies by sector in which companies are active

Sector in which company is active	Manufacturing companies	Service companies	Total
Number of studies	37	2	39

Source: authors' survey.

Table 3: Distribution of companies in the sample by geographical area and economic sector

	Europe	North America	Total
Financial services	20	13	33
Cyclical services	56	31	87
Non-cyclical services	19	9	28
Technological services	17	27	44
Total	112	80	192

Source: JCF and author's calculations