PART I

Introduction

1 Why study emerging-market multinationals?

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As developing and transition economies opened up to the global economy in recent years, a number of local firms not only survived the battle for markets at home, they expanded internationally through exports and foreign direct investment (FDI) to become fledgling multinational enterprises (MNEs) in their own right. By 2007, the more prominent emerging-market MNEs (hereafter referred to as EMNEs) included firms such as China's Huawei in telecommunications equipment, Mexico's Cemex in cement, Russia's Gazprom in energy, India's Tata Consultancy Services in information technology (IT) services, and Brazil's Embraer in regional jets. Many more firms in emerging economies were preparing to go down the same path in the future. Business magazines, such as *BusinessWeek* (2006) and the *Economist* (2007), trumpeted this trend with cover stories on "emerging giants" or "globalization's offspring" and illustrated the disruptive effects EMNEs were having on established Western multinationals. Consulting companies, such as McKinsey & Co. and the Boston Consulting Group (BCG), also took notice of these potential clients.[2] There was a parallel increase in studies on EMNEs by international business (IB) scholars, although no consensus emerged on whether and how EMNEs differed from multinationals that had come before.[3]

Why have EMNEs come into prominence in the past decade? What competitive advantages did they leverage as they internationalized? Were they distinctive in any way because they originated in emerging

[1] I would like to thank Jitendra V. Singh and other participants in the NU-Wharton conference for useful conversations leading up to this chapter.
[2] See Sinha (2005) in *McKinsey Quarterly* and Boston Consulting Group (2006), which identified 100 global contenders from 12 rapidly growing economies.
[3] Aulakh 2007; Buckley *et al.*, 2007; Child and Rodrigues, 2005; Dunning, 2006; Goldstein, 2007; Khanna and Palepu, 2006; Luo and Tung, 2007; Mathews, 2002; Narula, 2006; Ramamurti, 2004; and Zeng and Williamson, 2007.

economies? What internationalization strategies did they pursue, and why? What impact were they having on their respective global industries? How consistent or inconsistent is the rise of EMNEs with mainstream IB theory? These are some of the questions we explore in the pages that follow.

This project was based on three premises. First, we view the rise of EMNEs starting in the early 2000s as a long-term trend with important consequences for the global economy, rather than a flash in the pan. Like Korean and Japanese companies that came before, emerging-market firms were seen as capable of becoming global giants in a number of industries in due course. By some accounts, EMNEs were already among the world's top twenty firms, in such industries as container shipping (eight firms), petroleum refining (six firms), steel (five firms), mining (three firms), electronics (three firms), and telecommunications (two firms) (UNCTAD [United Nations Conference on Trade and Development], 2007: 123). There was no assurance, of course, that EMNEs would grow steadily in the future as they had in the early 2000s, when, arguably, all the stars were aligned for their ascendance. On the other hand, if the twenty-first century really belonged to emerging economies, as some have claimed (e.g., Wilson and Purushothaman, 2003; van Agtmael, 2007), then these countries could reasonably be expected to spawn many more EMNEs.

A second premise of the project was that IB theory could explain a lot about EMNEs, but not everything of interest to managers and policy makers. Studying EMNEs was therefore seen as a way to enrich existing IB theory, particularly about the process by which firms internationalize and become multinational enterprises. However, to ensure that insights from extant IB theory were taken fully into account in our research, prominent IB scholars participated in the Northeastern University-Wharton School conference at which authors presented their preliminary chapters.

The third premise was that a collaborative research effort would be the most productive way forward, given that EMNEs were relatively new actors on the global stage and hailed from a heterogeneous set of countries – even if those countries were often lumped together under the label "emerging economies." Accordingly, we invited a team of scholars to write papers on EMNEs specifically for this volume. They were leading IB scholars deeply familiar with the countries about which they were writing. All but two of the country studies (Mexico and South Africa) had at least one co-author from the country involved. Our sample covered the famous "BRIC" economies – Brazil, Russia, India, and China – plus four other emerging economies. We hoped that juxtaposing the country experiences and company studies would allow us to discern more clearly the country-level and industry-level variables that shaped the competitive advantage of EMNEs.[4] To be sure, including so many countries and researchers could make it harder to reach conclusions, but given the topic's novelty and complexity we felt alternative approaches would amount to oversimplification. We believed that you had to understand the lay of the land and the facts on the ground before rushing to conclusions about EMNEs or zeroing in on very specific research questions and hypotheses, as some prior studies have done.[5] We expect follow-up studies to be focused more narrowly on particular industries, countries, or issues.

Multinationals from rich and poor countries

In the post-WWII period, most of the world's FDI flowed from one advanced economy to another (see Cell 1 in Figure 1.1). Therefore, even as most of the world's largest MNEs were based in the advanced economies, most of the research on MNEs was about Cell 1 cases – for example, American companies investing in Europe, or European companies investing in the US.

Cell 2 is probably the next most widely researched case by IB scholars, because even in the 1970s, more than 20 percent of global FDI flows went to developing countries, especially after the commodity-price boom of the mid-1970s (Weigel *et al.*, 1998: Figure 2.4, p. 16). The strategies of Western MNEs in developing countries and their stormy relations with host governments, sometimes resulting in outright expropriations by host countries, caught the attention of IB scholars and development economists (e.g., Kobrin, 1977). Cell 2 assumed renewed importance in the 1990s, when many developing

[4] This is in keeping with the plea by Tsui (2007: 1358) for developing "context-specific indigenous theories."
[5] For instance, one detects a rush to judgment in consulting company studies such as those by Sinha (2005) and the Boston Consulting Group (2006), and other studies, such as Mathews (2002) or van Agtmael (2007).

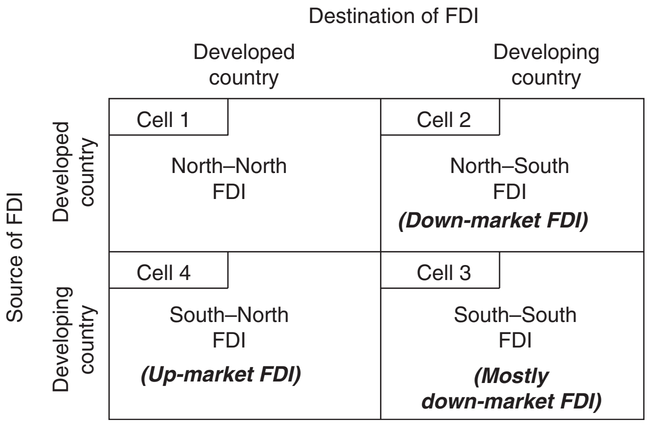

Figure 1.1 Source and destination of FDI.
Note: Down-market FDI refers to investment from a more developed country to a less developed one, and up-market FDI refers to the opposite

countries set aside their hostility to MNEs and welcomed them instead with open arms. At the same time, sweeping reforms in China and other transition economies created vast new opportunities for MNEs. By 2004, FDI from advanced countries to emerging economies accounted for almost 30 percent of global FDI flows.[6] Concomitantly, research on Cell 2 situations grew significantly.

To date, most of the research on FDI has been about Cells 1 and 2, that is, about investment originating in advanced countries. The fact that most research on MNEs was conducted by Western scholars, particularly in the United States, further skewed the research on MNEs towards Cells 1 and 2.

In the late 1970s and early 1980s, however, outward investment from developing countries received attention from IB scholars for the

[6] This was estimated from data in *World Investment Report 2006*. Total outward FDI in 2004 from developing and transition economies was $60 billion, excluding outflows from offshore financial centers, almost all of which went that year to other developing and transition economies (p. 118). Subtracting this amount from the total inward FDI into developing and transition economies that year ($275 billion, p. 299), suggests that $215 billion came from advanced countries (Cell 2). Given that worldwide FDI outflows that year (excluding $66 billion from offshore financial centers) was $747 billion, Cell 2's share is 29 percent.

first time, at the same time as the first significant wave of outward FDI from developing countries took place (Wells, 1977). At least two-thirds of that outward investment went to other developing countries (Wells, 1983: 4), that is, they were predominantly of the Cell-3 type, or what is sometimes referred to as South–South investment. Studies from this period shed light on the distinctive aspects of South–South investment (e.g., Wells, 1983; Lall, 1983; Kumar, 1982; Lecraw, 1977), but work on Cell 3 situations petered out as South–South FDI failed to keep pace with overall growth in FDI, partly because the leading source of outward FDI from developing countries – Latin America – got mired in debt crises during the 1980s. Even at its peak, though, outward FDI from developing countries in the 1970s represented only a small percentage of global FDI flows (UNCTAD, 2007). Moreover, since Cell 3 cases did not affect advanced countries, they did not receive much attention in the West.

Of the four cells in Figure 1.1, the least studied was Cell 4, which represented FDI originating in developing countries and destined to advanced countries. To be sure, this neglect was largely justified by the facts. At best, such flows represented one-third or less of the outward FDI flows from developing countries, which itself in past years represented one-tenth or less of overall global FDI flows. And even when it occurred in the 1960s and 1970s, Cell 4 cases were probably seen as aberrations, originating in atypical developing countries, such as Hong Kong, which at the time was an unusually open economy (Lall, 1983, ch. 3). In most other developing countries, Cell 4 investments were a rarity, although they did occur from time to time – for example, when the Indian firm Kiroloskar bought up 48 percent of a German engineering company in 1965 (Lall, 1983: 22).

The second wave of outward FDI from developing countries began in the 1980s in countries such as Hong Kong, Singapore, and Taiwan, but spread to many more countries in the early 1990s. Annual FDI outflow from developing and transition economies peaked at $133 billion in 2000, then fell to one-fourth of the peak, followed by a rally that took it to $174 billion in 2006 (UNCTAD, 2007: 251). Outward FDI from emerging economies (i.e., developing and transition economies) could no longer be ignored. By 2006, the outward FDI stock of emerging economies exceeded $1,600 billion, compared to $149 billion in 1990 (UNCTAD, 2007: 255). In this second wave, the outward FDI from emerging markets represented 14 percent of global

FDI flows, which was substantially higher than in the 1970s. This was all the more impressive because FDI outflows from advanced countries also surged in this period, from $50 billion in 1980 to $218 billion in 1990 and $1,023 billion in 2006.

The share of outward FDI from developing countries going to advanced countries averaged 20% between 1985 and 2004, reaching a high of about 35% in 2000 (UNCTAD, 2007: 118). These Cell 4 investments made headlines in the West, because they belonged to the "man-bites-dog" category of news stories: you had firms from poor, underdeveloped countries investing in rich, developed countries, which puzzled many observers, including FDI scholars. Among the recent headline-grabbing Cell 4 cases were China National Offshore Oil Corporation's (CNOOC) failed bid for Unocal, Lenovo's acquisition of IBM's personal computers business, Mittal Steel's merger with Arcelor of France, Russian Lukoil's acquisition of Getty Oil, and Tata Steel's takeover of Anglo-Dutch Corus Steel, to name just a few examples. There were many more examples of Cell 4 investments, as the country studies in this volume show.

Cell 4 cases are interesting theoretically, because they go against the grain of conventional wisdom about the direction in which capital, technology, and knowledge should flow in the global economy – that is, from advanced economies to emerging economies. Cell 4 is a good example of a situation that extant IB theory fails to explain well.

The focus of this book is on Cells 3 and 4, both of which deserve more attention than they have traditionally received from IB scholars, not because they account for the lion's share of global FDI flows – which they do not – but because they are important to the home countries involved and because of the disruptive effect that EMNEs seem to have on their global industries. The rise of Cemex, Embraer, Huawei, or Tata Consultancy Services (TCS), for instance, caused considerable turmoil for Western MNEs. In the case of Cemex, a tranquil, regional industry was turned into a dynamic, global one, forcing established cement firms such as Holcim of Switzerland and Lafarge of France to quickly bolster their global presence (Ghemawat and Matthews, 2000; Lessard and Lucea, Chapter 10 in this volume). Brazil's Embraer was a real thorn in the side of Canada's Bombardier, which had earlier been the global market leader in regional jets (Goldstein, 2007; and Fleury and Fleury, Chapter 8 in this volume). Huawei's aggressive internationalization was at least one important reason why Siemens and Ericsson pooled their telecom equipment businesses and Alcatel merged with Lucent. And Indian IT firms such as TCS, Infosys, and Wipro forced giants such as IBM and Accenture to rethink their core business models (Palmisano, 2006; Ramamurti and Singh, Chapter 6 in this volume).

EMNEs are also important because they are potentially the Samsungs and Toyotas of the future. In the 1960s, about thirty Japanese companies, and no Korean companies, appeared on the Fortune Global 500 list, but in 2007 companies from these two countries and Singapore held ninety-two spots on the list (for Japanese companies on the list in 1962, see Amsden and Hikino, 1994: 116). Similarly, EMNEs from countries other than South Korea, Singapore, and Taiwan held forty-nine spots on the 2007 list, but could easily double or triple that number by 2020 or 2030. In 1999, China set an explicit goal to get fifty of its companies on to the Fortune Global 500 list by 2010, a target unlikely to be realized, because only twenty-four had made the list by 2007. But China's goal is indicative of its ambitions, and the extent of support for achieving them. For those interested in how new entrants can displace incumbent global giants, EMNEs will provide an interesting domain for further study.

EMNEs have also represented attractive financial investments, compared to their incumbent Western rivals. The point is illustrated by the profitability and valuations of Indian software service firms. In 2006, two such companies, Infosys and Wipro, had sales of only about $2 billion, compared to $18–20 billion for US rivals such as Accenture and EDS; yet, their after-tax profit margins were in the range of 20–25%, compared to 1% for EDS and 5% for Accenture, and their market capitalization was of the order of $30 billion, compared to $22 billion for Accenture and $13.7 billion for EDS (valuations as of January 23, 2007). This was one reason that Goldman Sachs, in its famous report on the BRICs, urged its clients to increase the weight of emerging economies in their global investment portfolios (Wilson and Purushothaman, 2003). Indeed, portfolio investors in emerging markets earned some of the highest returns during the period 2003–2007.

None of the above implies that the rise of EMNEs will be monotonic and permanent. It is quite possible that some of these firms will stumble or even collapse, because of overambitious strategies or poor execution (recall Korean Daewoo's experience after the Asian financial crisis). Emerging economies also face many economic and political risks that could derail their upward trajectories. Rising labor costs or currencies may undermine the low-cost advantage that many EMNEs enjoy in 2008. Protectionism may also rise in the advanced countries, slowing down the internationalization of EMNEs (Aharoni and Ramamurti, 2008). It does not take much imagination to construct negative scenarios of this sort. On the other hand, it is also quite possible that the turn towards free markets among emerging economies, particularly in Asia, will not be reversed, and that rapid domestic-market growth and openness to global competition will produce more EMNEs in the future, not just in low-technology or commodity businesses but quite possibly also in industries employing sophisticated technologies and requiring sophisticated marketing skills.

Research questions and prevailing IB theory

In studying emerging multinationals from developing and transition economies (i.e., Cells 3 and 4 in Figure 1.1), we are interested in answers to the following questions:

(1) What competitive advantages and capabilities do EMNEs leverage in international markets, and how are those advantages and capabilities shaped by the home-country context?
(2) What internationalization strategies do they follow, and why?
(3) What impact is their rise having on global industry dynamics, including established Western MNEs?

The first two research questions are not unlike those asked by researchers who have studied Cells 1 and 2, and they were also probed by researchers studying Cell 3 when the first wave of outward FDI from developing countries occurred in the 1960s and 1970s. The more fundamental question is whether the concepts and theories developed by studying Cells 1 and 2 are equally relevant for Cells 3 and 4. It is possible, a priori, to argue for either side of this issue.

On the one hand, all four cells entail firms making cross-border direct investments, and for that reason a common set of concepts, frameworks, and theories may well explain them equally effectively. Several mainstream IB ideas, such as Dunning's Ownership-Location-Internalization (OLI) framework (Dunning, 1977), the motivations for internationalization (market-seeking, resource-seeking, strategic asset-seeking), the notion of "liabilities of foreignness" (Zaheer, 1995), or the stages-model of internationalization (Johanson & Vahlne, 1977), may apply as well to Cell 3 and 4 situations as they do to Cell 1 and 2 situations. After all, the only difference across the four cells is the state of one contextual variable – a country's level of development. While level of development is clearly important, it may not be so powerful a contextual variable as to nullify the explanatory power of mainstream IB theories for how and why firms become multinational enterprises. This is particularly true of abstract frameworks, such as the OLI framework, which posits a set of general conditions that an organization must meet in order to become multinational. It states, for instance, that a firm cannot become multinational unless it possesses firm-specific or ownership advantages that offset the disadvantages of operating in a foreign country, or that firms expand internationally only if there are location-bound advantages in foreign countries that cannot be exploited without a presence in those countries, or that a firm will internalize international transactions only if alternative arm's-length arrangements for exploiting foreign opportunities are less profitable. These assertions are general enough that they may hold regardless of context. Indeed, in his 1983 work on Third World multinationals, Wells posed the question raised here and came to the following conclusion:

> Can the same concepts that have proved useful in studies of the traditional multinationals help in understanding the new foreign investors [Third World multinationals]? My contention is that they can and the process of applying the concepts to the new firms aids in understanding both the concepts and the different kind of multinationals. (Wells, 1983: 6)

On the other hand, context becomes much more relevant if one is interested in substantive answers to the questions that motivated this research project. If one would like specifically to know what ownership advantages multinational firms from different countries enjoy and why, or what the location advantages of different countries are, or what particular internationalization paths firms are likely to follow in different contexts, then context-free frameworks are inadequate. For instance, the ownership advantages most commonly attributed to MNEs from the West include proprietary cutting-edge technologies, marketing prowess, and powerful brand names. None of these is usually a source of competitive advantage for MNEs from developing