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978-1-107-03255-2 - The Competitive Advantage of Emerging Market Multinationals

Edited by Peter J. Williamson, Ravi Ramamurti, Afonso Fleury and Maria Tereza Leme Fleury

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Introduction

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Until recently, when the question ‘what are the competitive advantages of multinationals from emerging economies in the global market?’ was posed to either academics or Western executives it typically elicited a simple response: ‘None’. To the extent that these firms from emerging economies were winning market share abroad, this was explained by the fortuitous access to so called ‘country-specific advantages’ (CSAs) such as a pool of low-cost labour in their home base (Rugman and Verbeke, 2001). Their success was viewed as a legacy of their birth. They were generally thought to lack ownership of the rich stocks of proprietary, intangible assets that theory argued was required for multinationals to be an efficient organisational form (Caves, 1986). Dunning (2001) termed the benefits of these intangible assets ‘ownership advantages’ – a term chosen to emphasise the idea that the transaction costs involved in transferring these assets (and hence their associated advantages) across borders using market mechanisms are higher than the costs of transferring them internally within an organisation under the same ownership. Without these intangible assets there was no reason why their products and resources should not be exchanged internationally through trade in an open market. According to a strict interpretation of this theory, therefore, the existence of emerging market multinational enterprises (EMNEs) must simply be the result of market distortions such as trade barriers or government support.

This received wisdom has begun to look increasingly implausible because EMNEs have continued to expand globally, in many cases successfully taking market share from multinationals headquartered in developed market multinational economies (DMNEs) that benefit from global capabilities and networks built over many decades (Verma *et al.*, 2011). These EMNEs have also invested directly in building their subsidiaries overseas, both in the developing and developed world. According to the United Nations Conference on Trade and Development (UNCTAD) World Investment Report (2011), almost

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25 per cent of all global foreign direct investment (FDI) in 2010 emanated from emerging economies, which accounted for six of the top-twenty investing countries. As a result, a number of EMNEs now have configurations of different value-generating activities that span the globe. Huawei, now the world's second-largest supplier of telecoms equipment by revenue, has operations in over 140 countries. Its twenty-three-country global research and development (R&D) network now includes centres in France, Germany, India, Italy, Russia, Sweden and the UK. The Brazilian company Vale, meanwhile, has mining operations in Bahrain, Belgium, Canada, France, Norway and the US. It also has 150 minerals exploration and R&D projects underway in twenty-one countries spanning three continents.

Meanwhile EMNEs have been the source of innovations that they have deployed across the world such as: the development of ultra-deep water, 'pre-salt' oil production technology by Petrobras, now being deployed in Africa, the Middle East and the Gulf of Mexico; Moscow-headquartered Kaspersky Lab, which has developed sophisticated anti-virus software supplied to leading global corporations such as Microsoft, IBM and Cisco and has offices in China, France, Germany, India, Japan, the Netherlands, Poland, Romania, South Korea, Sweden, the UK and the US; and Indian firms such as Wipro and Infosys that pioneered innovative, global business models to deliver information technology services.

EMNEs have also been increasingly active in the market for cross-border mergers and acquisitions (M&A): in 2011 they accounted for 29 per cent of global cross-border acquisitions by value according to UNCTAD. These investments would not be economically rational, nor profitable for shareholders, if EMNEs were relying solely on home-country advantages that were available to all their competitors or could be efficiently transferred internationally via arms-length market transactions. In the case of cross-border M&A, it might be that EMNEs are seeking to acquire the resources they lack to be competitive globally (Bresman *et al.*, 1999; Forsgren, 2002). But this explanation leaves unanswered the question of whether EMNEs are able to out-bid their established multinational rivals in the global market for corporate control and still make such acquisitions profitable (Gubbi *et al.*, 2009).

Given that EMNEs are rapidly becoming important players on the global stage and that traditional theories seem to provide, at best, an incomplete explanation of their behaviour and performance

(Girod and Bellin, 2011; Ramamurti, 2012), it is opportune to take a new look at the sources of competitive advantage enjoyed by EMNEs. That is the goal of this book. In the chapters that follow we will seek to reassess the roots, the evolution and the current extent of EMNEs' competitive advantages and the role that internationalisation has potentially played in building and strengthening these advantages. This work builds on the seminal book by Ramamurti and Singh (2009a) that explored the competitive advantage of EMNEs primarily from the standpoint of the country-specific advantages these firms had harnessed, and another by Fleury and Fleury (2011), which thoroughly examined the foundations of internationalisation by Brazilian firms.

Through our reassessment we also hope to shed further light on a number of fundamental questions that the rise of EMNEs poses for the theory and practice of international business. Perhaps the most basic and far-reaching of these questions is whether the behaviour of EMNEs and their impacts on global competition require a new theory, or whether what we observe can be explained by adapting existing models of how multinationals evolve and compete.

The roots of much of the existing theory can be traced back to the experience of firms, primarily from Europe and the US, who began their international expansion in the nineteenth century (Wilkins, 1970; Chandler, 1980). This experience shaped the concept of multinationals as 'arbitragers' as well as establishing the idea that national country of origin was a primary force shaping the way particular multinationals evolved. International business researchers studying multinational firms that expanded their networks following the second world war also contributed key assumptions on which subsequent theories have been built (Wilkins, 1974). These included the idea of FDI moving 'advantages' (Hymer, 1976) from more developed markets to less developed ones (often driven by barriers to trade and government policies to promote import substitution) and the role of maturation of technologies and products along a lifecycle as a primary determinant of location (Vernon, 1966). These early, post-war studies were largely based on samples of US firms – perhaps not surprisingly, as the US accounted for an estimated 85 per cent of global FDI between 1945 and 1960 (Jones, 2005: 7).

It is clear, therefore, that our theories about the emergence of multinationals and the drivers of FDI have been shaped by a rather particular set of national and historical contexts (even if these influences are

seldom acknowledged or perhaps even recognised). If these contexts differ in important ways from the environment that prevails today then we might expect the EMNEs of the twenty-first century to behave differently and achieve different results from multinational firms that expanded their international reach and competitiveness in earlier eras.

In fact, there are at least five reasons why we might expect existing theory to be less than perfectly applicable as a tool for understanding the current expansion of EMNEs and their sources of competitive advantage.

First, we might expect that the strategies adopted by firms expanding internationally in today's environment that is already highly globally integrated to differ from the one riven with protectionist barriers and impediments to the flow of capital and products across the world on which much of the existing theoretical concepts have been based. The higher level of global integration, more advanced communication technologies and freer flows of everything from capital to information across the world, might be expected to influence the potential strategies followed by companies as they seek to become globally competitive.

Second, the way in which a firm develops from a national player to become a multinational might be expected to progress through a cycle. In comparing EMNEs with DMNEs and looking for similarities and differences, therefore, we need to compare companies at the same stage in their cycle of development; not mature multinational companies with those in the early stages of their development cycle (Ramamurti, 2009b: 419–20).

Third, EMNEs do not seem to follow the pattern of the product life cycle theory (Vernon, 1966) that postulates that products move from developed to developing countries as the product matures. EMNEs often shift products, processes and know-how from the developing or emerging economies to developed markets.

Fourth, EMNEs do not always seem to expand their international operations incrementally starting with regions with low psychic distance from their home market to regions with higher psychic distance (Vahlne and Wiedersheim-Paul, 1973; Zaheer, 1995). Instead, they often appear to establish subsidiaries or make acquisitions in locations with high psychic distance from their home base. This may reflect a fifth difference from established theory: that EMNEs appear to emphasise the role of internationalisation as a means to access new locational advantages rather than to exploit ownership advantages.

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Yet prevailing theories suggest that strategies based purely on exploration will not be competitive against incumbent multinationals that have existing ownership advantages (Dunning, 2001) because the latter can already transfer them around the world more efficiently than the newcomers.

These differences between the current environment and the context that shaped much of our existing theory, along with observations about the rise of EMNEs and the nature of their international expansion that seem paradoxical when viewed through established theoretical lenses, at least requires us to reassess the explanatory power of existing theories.

With the growing number of economies now being classified as ‘emerging’ or ‘growth’ economies, and the multitude of potential sources of competitive advantage, the goal of understanding the competitive advantages of EMNEs risks becoming a Herculean task. In order to keep it within tractable bounds we have decided to focus our core analysis on multinationals venturing abroad from the four largest emerging economies: Brazil, Russia, India and China – dubbed by Jim O’Neill of Goldman Sachs the ‘BRICs’. In drawing conclusions from studying the BRICs in the final chapter we will seek to examine the implications and applicability of our findings to the non-BRIC emerging economies. We also decided to concentrate on three, inter-related potential contributors to competitive advantage: the innovation capabilities of EMNEs; the way in which they have sought to access and combine different resources and strengths by locating different activities in different geographies (their ‘value-chain configurations’); and the role of cross-border M&A in helping EMNEs to access complementary resources and learning that can be integrated with their existing capabilities to build new sources of competitive advantage.

Clearly this list of potential contributors to EMNEs’ competitive advantages is by no means exhaustive. In the course of our examination we have sought to understand other sources of competitive advantage from which EMNEs might be benefitting – especially those non-traditional firm-specific advantages (FSAs) suggested in existing literature such as the ability to unlock latent demand in low-end segments (Prahalad, 2005), or capabilities in dealing with weak institutions and infrastructure (Morck *et al.*, 2008; Cuervo-Cazurra and Genc, 2008). Where possible, we have also considered how CSAs, both from the firm’s country of origin and from the locations where

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they have established subsidiaries, have contributed to the creation of competitive advantages within EMNEs. Where appropriate we have considered the effects of other factors such as economies of scale, home and host government policies, market power, branding, institutional context and governance. We believe that by focusing on innovation, value-chain configuration and M&A and their interactions as the key channels through which EMNEs develop their competitive advantage, we have adopted a framework within which many and varied contributors to EMNEs' competitive strength can be fruitfully explored.

Within the framework we seek to examine not only the 'raw materials' from which EMNEs create competitive advantages, but also the processes they have adopted to build those advantages. These processes include the key role of their absorptive capacity (Cohen and Levinthal, 1990) and EMNEs' use of dynamic capabilities to convert their domestic CSAs and resources accessed abroad into competitive advantages (Teece *et al.*, 1997). For example: How have Chinese MNEs used acquisitions to acquire new technologies or R&D capabilities that came to be combined with their internal product and process design and manufacturing capabilities to create new sources of competitive advantage? How have Russian MNEs configured their value chains to leverage the natural resource endowments in the home country? How have Indian MNEs absorbed host-country knowledge and adapted their innovative business models to gain competitive advantage in other emerging markets? How have Brazilian firms transferred production competences from overseas subsidiaries to headquarters to improve their competitive advantage both at home and abroad?

The remainder of the book is organised as follows. In Part I, four chapters are devoted to the question of how (and to what extent) innovation capabilities have contributed to the competitive advantages in global markets among multinational firms emerging from Brazil, Russia, India and China respectively. For the purposes of the analysis in this section we have consciously adopted a broad definition of 'innovation' that goes beyond technological break-throughs to include business model innovation, novel improvements in the price/performance ratio of product offerings, and innovations in management systems and processes, etc. This reflects our belief that commentators in the past have risked overlooking some of the most important innovations that are providing EMNEs with competitive advantage by focusing too narrowly on advanced technology, R&D spending or patent registrations as the

measures of innovation. Part I concludes with two commentaries, each of which seeks to compare and contrast the findings for innovation as a source of EMNEs' competitive advantage across the four countries and suggest conceptual frameworks that might shed light on the commonalities and divergences observed.

In Part II, four further chapters explore the ways in which EMNEs have configured their value chains so as to span different locations in ways that enable them to exploit their existing competitive advantages as well as to access new resources and knowledge that can be used to create new types of competitive advantage. Thus EMNEs may establish subsidiaries (or other types of presence such as joint ventures, alliances, or equity stakes) in other locations so as to access resources including finance, technology and knowledge, natural resources, customer intelligence, or brands that can be used to enhance the competitive advantage of their companies in global markets. One of the interesting features of EMNEs' strategies here, compared with their cousins from developed economies, is that they are much less likely to fully relocate production or other core operations overseas. Instead they are apt to build value-creating activities such as R&D or marketing overseas – these were the very activities that DMNEs were last to relocate offshore (if they do so at all). Again, Part II concludes with two commentaries that compare and contrast the value-chain configurations of multinationals from the four BRIC countries examined in this section and aim to develop a conceptual framework that helps to explain the different roles of value-configuration strategies in contributing to EMNEs' evolving competitive advantages.

Part III examines the role of offshore M&A in providing access to resources and knowledge that can be combined with EMNEs' home-based resources and capabilities to extend existing sources of competitive advantage and create new ones. A key area of investigation here is whether EMNEs are using offshore M&A in ways that are any different from DMNEs; specifically, our intuition from anecdotal evidence and existing research (Gubbi, 2009; Guillén and Garcia-Canal, 2009) was that offshore M&A by DMNEs is of the market-seeking type (buying a 'market position' as described by Haspeslagh and Jemison, 1990), while in the case of EMNEs it is more likely to be of the strategic-asset-seeking type (i.e., to gain rapid access to competences such as R&D or marketing). Where EMNEs acquired substantial market share positions in foreign markets, meanwhile, we hypothesised

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that their strategy might be to attempt to drive further global consolidation in industries considered mature in developed markets. Again the concluding commentaries that act as a ‘book-end’ to this section compare and contrast the evidence from across the four BRIC countries and propose a theoretical framework to better understand the role of cross-border M&A in helping EMNEs build their global competitive advantage, including complementing and enhancing their existing innovation capabilities and adding additional ‘pieces of the jigsaw’ that help them move towards their desired international value-chain configurations.

In the concluding chapter of the book we step back to review the overall evidence on how EMNEs are using globalisation not only to exploit their existing advantages, but also to explore the world for new learning and capabilities that they can combine with their existing experience to evolve novel and powerful types of advantage to compete in global markets.

We then explore some of the similarities and differences between EMNEs from the different BRIC countries in terms of the role CSAs have played, the industries on which they have focused and the sources of competitive advantage on which they have built. This allows us to revisit the role of critical factors such as knowledge flows and learning, government policy, industry maturity and the global market environment in the shape and pace of EMNEs emergence. In discussing these factors we tackle the question of whether, in the light of what we have observed from this in-depth study of the emergence of EMNEs from the BRIC countries, we need to revise, adapt or perhaps more fundamentally renew established theories of how and why companies internationalise.

Comparing the similarities and differences between EMNEs from different BRIC countries also paves the way for an assessment of the implications our findings might have for the multinationals that are now starting to venture forth from other emerging economies in Asia, the Middle East, Latin America and Africa beyond the BRICs. Finally we conclude our discussion by drawing out some of the implications for managers and policy makers – both those concerned with developing successful strategies through which EMNEs can continue to strengthen their competitiveness and global reach, and those whose remit is to work out how developed economies and DMNEs need to respond to prosper as the new phenomenon of EMNEs continues to develop apace.

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PART I

*Innovation and competitive
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