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# 1

## Introduction

### Summary

*In this early part of the 21st century, deals such as the acquisition of the IBM personal computer business by Lenovo of China, Cemex's emergence as one of the world's largest producers of cement, and Chinese investments in the Canadian energy sector have made evident the increasing relevance of outward foreign direct investment (OFDI) flows from developing countries. The phenomenon is not completely new – indeed, the term “Third World multinationals” gained currency in the 1970s and 1980s – but its foundations have fundamentally changed. In today's global economy, emerging multinationals are no longer niche players; they operate on the basis of some form of competitive advantage. Identifying them, however, remains a key research and policy issue.*

Cross-border capital flows are a distinguishing feature of the contemporary global economy, possibly to an even larger extent than international trade. Therefore, the takeover of Ikegai, the opening of a new restaurant in Singapore, and a recruitment drive by restaurants in the United States – all events that took place in July–August 2004, when this study was started – should hardly raise an eyebrow. Yet, what was unusual was that the investor that rescued the first company, Japan's oldest lathe manufacturer, is China's Shanghai Electric; the eateries that made their debut in the very competitive Singapore market, Cabbages and Condoms, distinguish themselves by being Thai, serving condoms instead of after-meal mints, and funneling all profits into AIDS education and environmental protection;<sup>1</sup> and the restaurants that sponsor US entry visas for skilled waiters, arguing that *churrasco* skills are unavailable in the US job market, hail from Brazil.<sup>2</sup> Such deals are not confined to

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bankrupt companies and admittedly low-tech service sectors such as fast-food restaurants. In that same period, Noranda, a Canadian copper and nickel mining company, entered into exclusive negotiations with China Minmetals, China's biggest base metals company, after shareholders turned down a rival bid by Brazil's CVRD.<sup>3</sup>

These examples, and many others of acquisitions of companies based in industrial countries by competitors from the developing world (see Appendix 1), show that even when they lack the scale, the intellectual property portfolio, and the market power to push their own brands, emerging market multinational corporations (EMNCs) intend to use acquisitions to build global recognition and expand their innovation and manufacturing bases. What are relatively new, moreover, are the forms that foreign direct investment (FDI) from non-developed countries is taking, the motivations, and the effects. In sum, the ability to fund considerable financial arrangements in sophisticated markets, or to build distinctive and highly competitive corporate characteristics and resources, is no longer confined to "Northern" firms.

The rise of so-called Third World multinational companies (3WMNCs) was documented by a number of authors two decades and more ago.<sup>4</sup> Wells (1983) explores why firms based in developing countries have chosen to invest in branches, joint ventures, and wholly owned subsidiaries overseas rather than simply export goods or enter into licensing arrangements abroad. Drawing on the product-cycle model, his analysis emphasizes the ability of 3WMNCs to adapt existing process and product technologies (including second-hand equipment), "descale" them (i.e., modify them so they work at smaller scales) and produce at low costs with small production runs and inexpensive labor. Lall (1983), on the other hand, gives pride of place to proprietary advantage in industrial technology: 3WMNCs "may develop advantages in specialized products and processes only if the localization of technical change ... affords scope for the development of proprietary technological assets" (p. 261).<sup>5</sup> Technology may be the main driver of international expansion if this expansion is to countries with a lower level of development (Diaz-Alejandro 1977) and if firms gain the capacity to internationalize through a cumulative learning-by-doing process (Tolentino 1993). The studies in Oman (1986) also underline the fact that 3WMNCs supply resources and services that are better adapted to the needs of developing countries. A non-technological dimension is added to explain their success in penetrating new markets. These firms are willing to use non-traditional forms of investment (joint equity ventures, licensing, management agreements, turnkey operations) that both host governments and home-country authorities prefer – the former because

of the expectation that more know-how will be transferred, the latter because the associated cash outflows abroad will be smaller.

Although such monographs and collections of country studies to some extent emphasized different factors, these early studies reported that international Third World firms operated in a wide range of industries and were by no means confined to either labor-intensive or mining sectors. Country chapters showed Indian and Argentinean firms to be particularly strong on production engineering and basic design capability (Lall 1983), while Brazilian civil engineering contractors mastered some specific technologies and learned how to execute large-scale works under very tough environmental conditions (Guimaraes 1986). And yet, albeit with nuances, the general belief was that companies from non-industrial economies could hardly ever rise to become formidable global competitors (see especially Heenan and Keegan 1979). In particular, evidence for innovation-generating development activities was found to be very sparse (Wells 1983: 156). In his study of 3WMCs in Mauritius and the Philippines, Busjeet (1980) makes it clear that “external market and cost considerations were more important in the foreign investment decision than the desire to exploit the skills and resources of the firm” (p. 61).

Following the widespread, albeit incomplete and at times flawed, process of economic reform and liberalization that the “South” has gone through since the late 1980s, EMNCs have learned at least some of the tricks of the global economy. Domestic trade liberalization has increased competition on hitherto protected markets, reduced margins at home, and pushed surviving firms into export expansion. Sometimes, firms in developing countries have had to learn new business tricks well before they have become common in OECD (Organisation for Economic Co-operation and Development) markets – possibly the best example being the pro-market regulatory regimes in network industries that were introduced in Latin America during the late 1980s/early 1990s, when in most industrial countries utilities were still largely state-owned monopolists. As a result, such firms found themselves at an advantage when competing with OECD firms on third markets. In other instances, EMNCs have created value by identifying and successfully exploiting opportunities that were opened up by operating in turbulent environments (Sull and Escobari 2004).

Rather than conventional notions of corporate strategy, such as the imperative to predict accurately efficient combinations of position, resources, and competencies, EMNCs have mastered the art of experimenting with flexible solutions to respond to unexpected twists in the business environment. In this sense they have been able to turn what was

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*prima facie* a liability – unpredictable, when not missing, markets – into an asset (for instance, the proclivity to build up slack resources as a valuable cushion against unforeseen crises). Also, big business in developing countries has become an active player in the global alliance game that defines modern capitalism (Dunning 1995), first by setting up joint ventures in home markets, then expanding together into regional ones, and eventually, in some cases, buying out its OECD-based partners. Some businesses have also ridden the waves of paradigm changes: in electronic equipment, in particular, it was the transition from analog to digital that gave Samsung and other Korean companies the opening they needed to compete with long-established rivals.

These developments call for new research into the international expansion of such companies, bridging the gap between the existing literature on business in emerging economies – which often portrays corporations as rent seekers that flourish as a result of privileged access to political, financial, and transactional resources – and the increasing attention that scholars are devoting to dynamic capabilities as the basis for corporate success (Dosi *et al.* 2000). Factors such as protecting proprietary processes and competitive advantages, “learning by competing” in high-income markets, following important customers, and the increasingly global nature of management (in terms of citizenship, education, recruitment, and professional background) all combine to explain the decision to invest abroad. In this sense, theories and research methodologies developed in international business research can provide new insights into the dynamics of EMNCs.<sup>6</sup> In particular, they may help clarify the conditions under which EMNCs move from “exploiting” existing technologies to “explore” potentially superior ones and generate patterns of self-sustaining growth. And yet there is probably some truth in the expectation that MNCs will differ depending on the income level of their home economies – in particular that EMNCs, instead of relying primarily on non-imitable technological advantages when expanding abroad, seek sources of advantage in their social capital and distribution capabilities.

To advance this research agenda, scholars need to analyze the specific activities and capabilities of the firms involved, and the dynamic reconfiguration that links corporate strategies, FDI, and the broader social and environmental context. In particular, research must come to terms with the concept of heterogeneity across firms as the best way to extend existing models and make them more realistic but still theoretically sound. To a large, albeit still undetermined, degree, the resource and capability endowments enjoyed by MNCs differ in accordance with variations in

institutional structures and business systems (Yeung 2002). Standard economic models do not usually account for both the systematic heterogeneity observed in corporate competencies and the nuances of the mechanisms governing the dynamics of interactions among agents (firms, governments, institutions). However, there can be little doubt that soft factors (e.g., vision, ambition, commitment), microeconomic diversity, and institutional settings affect in non-trivial ways aggregate dynamics. Rather than considering only economic factors, an account of companies' internationalization trajectories needs to incorporate the formation and development of strategies, routines, objectives, and behaviors in specific social, cultural, and historical contexts. To this end, this book includes a fair number of embedded and longitudinal "business vignettes" to back up broader analytical observations with concrete examples. I hope it does not sound too presumptuous to remember that some of the founding scholars of international business studies, such as Raymond Vernon, John Dunning, and Edith Penrose, "placed a high priority on evolutionary and historical perspectives and methodology" (Jones and Khanna 2006).

Obviously, the reliance on case studies and anecdotal narratives is not without its risks, especially insofar as it does not lend itself to the quantitative testing that is now the standard social science methodology. This study, at any rate, is not so much about identifying regularities and making predictions as it is about shedding some light on the following research questions:

- What forms are FDI flows from the South taking in terms of target countries and industries, manner of entry and financing, macro- and microeconomic impact, and stage in the history of the MNC? What are the motivations for the corporate decision to internationalize via overseas investment in marketing, distribution, production, and innovation activities rather than pursue the alternative of exporting from the home country?
- What are the similarities and differences between EMNCs and their more established counterparts from the industrialized countries, both large and small? Can existing theories of international business serve for analyzing EMNCs? And, vice versa, what contribution does the study of EMNCs make to theories of international production? In particular, are firms from developing countries "dragon MNCs" that internationalize through investment at an earlier stage in their life than their counterparts from industrial nations?
- Will China and India, and developing Asia more broadly, become an important source of FDI to developing countries? What would be the

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beneficiary sectors – only natural-resource-intensive sectors? Would the poor benefit from these developments, or would they remain outside any benefits, especially if most FDI goes to resource-intensive industries? Does OFDI from emerging economies play a positive role in facilitating home economies' competitive insertion into the world economy? Is the development impact of EMNCs any different?

- What are the implications of these developments for North–South and South–South relations in general, and for relations between specific home and host countries? How should OECD governments react to this process? Is there reason to fear a disruption of the progressive economic and political liberalization that is seen as a core element of development assistance? Might EMNCs come to the rescue of sunset industries and ailing firms in OECD countries?

The following chapter reviews available data, highlighting the rise of the Asian Tigers and large emerging economies such as Brazil, China, India, Mexico, Russia, and South Africa as sources of global FDI flows. Attention is also drawn to some key methodological issues – on the one hand, the role of the diasporas and the broader difficulty in clearly classifying increasingly complex ownership structures; on the other hand, the so-called round-tripping phenomenon whereby domestic investors take advantage of incentives accorded to foreign companies by routing their investments through third countries. Chapter 3 analyzes industry dynamics, with particular emphasis on oil and service industries, while Chapters 4 and 5 focus on the entry and performance record of Asian and Latin American MNCs, respectively. Chapter 6 reviews the main threads in the economic and business literature on multinationals and their theoretical relevance for non-OECD countries. In particular, it is argued that a huge effort is needed to explore in greater depth and with more rigorous parameters the sources of corporate success, the extent of firm-level capabilities in innovation and knowledge management relative to competitors, and the heterogeneity of company trajectories, relying on both macro and co-evolutionary approaches. The multiple roles of governments – at the level of both policies and international political economy – are discussed in Chapter 7. Three main topics are identified in Chapter 8 as still gravely wanting in terms of deeper and better research – the role of diasporas in homeland FDI, the challenge of multinational management, and the impact of EMNCs on host economies. The consequences for OECD governments and firms are explored in Chapter 9.

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