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Internalization theory and the performance of emerging-market multinational enterprises

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ABSTRACT

Constrained by their peripheral position in the global factory system and underdeveloped institutions at home, emerging-market multinational enterprises (MNEs) are likely to achieve monopoly-based, rather than knowledge-based, financial gains from internationalization conditional on R&D. Emerging market MNEs need to engage in R&D to upgrade orchestration know-how within the global factory. This needs to be accompanied by the development of home-based enabling institutions. This article develops the argument based on internalization theory, and tests hypotheses against the experience of major emerging-market MNEs from 2004 to 2011.

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1. Purpose

In the past two decades a most significant development in international business has been the rise of emerging-market multinational enterprises (hereafter MNEs). Emerging-market MNEs, especially Chinese MNEs, rapidly expanded production and service facilities overseas, and aggressively acquired established brands across the globe (Peng, 2012; Ramamurti, 2009). The rise of emerging-market MNEs has attracted growing scholarly attention, and led to a fierce debate on the relationship between internationalization (the extent to which a firm engages in value-creating activities across national borders) and the performance of emerging-market MNEs compared to advanced-market MNEs (Contractor, Kumar, & Kundu, 2007; Hennart, 2012; Lessard & Lucea, 2009; Narula, 2012; Rugman & Li, 2007).

This article develops a moderated mediation framework, based on internalization theory, to explicate the impact of internationalization on the profitability of advanced versus emerging market MNEs. In this framework, internationalization may lead to knowledge-based financial gains or monopoly-based financial gains conditional on R&D investment in MNEs and on the locational constraints that MNEs face in the global factory system

and at home. In internationalization, advanced-market MNEs achieve knowledge-based financial gains partly due to their leadership position in the global factory system that allows them to develop a competitive advantage in orchestrating dispersed business activities in the system, and partly due to the enabling institutions at home that induce them to invest R&D resources in entrepreneurial experiments and risk-taking innovations. Emerging-market MNEs fail to do so and, instead, achieve monopoly-based financial gains partly due to their peripheral position in the global factory system that impedes their ability to learn global orchestration know-how, and partly due to the strong government intervention at home that induces them to invest R&D resources in monopolistic rent-seeking activities. The article derives hypotheses from the framework, and tests them against the experience of major emerging-market MNEs compared to major advanced-market MNEs from 2004 to 2011.

Our contention thus is that internationalization is likely to enhance monopoly-based rent and have a positive direct effect on profitability conditional on R&D in emerging-market MNEs. In contrast, for advanced-market MNEs, internationalization is likely to affect profitability indirectly through its role in strengthening the competitive advantage in orchestration of a global value chain. The contribution of the study therefore is threefold. Drawing on and extending internalization theory, firstly, the study develops a coherent and consistent framework to compare emerging-market

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MNEs with advanced-market MNEs in internationalization and performance. In testing the framework, secondly, the study empirically reveals the crucial differences in internationalization and performance between emerging-market and advanced-market MNEs. Thirdly, based on the findings, the study explicates the strategic approaches that emerging-market MNEs may take to catch up with advanced-market MNEs in knowledge-based financial gains from internationalization in the era of the global factory.

2. Theoretical framework and hypotheses

Early discussion focused on the direct relationship between internationalization and financial performance, and produced inconclusive findings (Chiang & Yu, 2005; Contractor et al., 2007; Elango, 2006; Kumar & Singh, 2008; Nachum, 2004). Recent research pointed to the lack of theoretical bases in early discussion, and followed the eclectic paradigm to take into account additional variables that influence internationalization and profitability (Lessard & Lucea, 2009; Rugman, 2009; Ramamurti, 2012; Verbeke & Forootan, 2012). According to the eclectic paradigm proposed by Dunning (1988), a firm succeeds in internationalization because 1) it has knowledge-based advantages in proprietary technology, management know-how and global brands over rivals in foreign markets, also named ownership advantages (Dunning, 1988) or firm specific advantages (Rugman & Verbeke, 1992); 2) it benefits from location advantages in endowment in cross-border competition, and 3) it gains internationalization advantages in minimizing transaction costs in imperfect markets. Some scholars invoked the eclectic paradigm to argue that internationalization is “really an intermediate variable, not an independent variable”, and that knowledge-based advantages are “the true independent variable” which determines internationalization and profitability (Rugman & Verbeke, 2008: 169). Emerging-market MNEs do not have the kind of knowledge-based advantages that advanced-market MNEs possess, and therefore cannot succeed in internationalization and financial gains in the long-run. Their phenomenon international success is based on their location advantages in such endowments as cheap labour and natural resources, and is short-lived because endowments are available to all firms (Lessard & Lucea, 2009; Rugman & Li, 2007; Rugman & Verbeke, 2008; Rugman, 2009; Verbeke & Brugman, 2009). Some scholars also adhered to the

eclectic paradigm, but argued that emerging-market MNEs do have knowledge-based advantages which differ from those possessed by advanced-market MNEs. Emerging-market MNEs have certain knowledge-based advantages that are developed in the specific tough environment at home, including “their deep understanding of customer needs in emerging markets, the ability to function in difficult business environments, their ability to make products and services at ultra-low costs, their ability to develop ‘good enough’ products with the right feature-price mix for local customers” (Ramamurti, 2012: 42). The home-born knowledge-based advantages enable emerging-market MNEs to outperform rivals in internationalization and profitability (Cuervo-Cazurra & Genc, 2008; Ramamurti, 2009; Zeng & Williamson, 2007).

Other scholars questioned the theoretical prediction of the eclectic paradigm that knowledge-based advantages determine a firm’s internationalization and profitability. They argued that internationalization can play an active role in augmenting knowledge and profitability. Mathews (2002, 2006) contended that emerging-market firms can develop knowledge-based advantages and profitability by linking with leading firms overseas, leveraging the linkage to access advanced technologies, and learning in the internationalization processes. Some firms in emerging Asia have managed to successfully internationalize “without any of the advantages of the incumbent industry leaders . . . without skills and knowledge . . . by leapfrogging to advanced technological levels, for example, or by leveraging their way into new markets through partnerships and joint ventures” (Mathews, 2006: 6). Similarly, Luo and Tung (2007) suggested that emerging-market MNEs can use internationalization as a springboard to augment knowledge and profitability. Dunning (2006) endorsed the argument for the active role of internationalization in augmenting knowledge and profitability, and believed that this argument is complementary, rather than contradictory, to the eclectic paradigm. Thus a notion loomed large in the debate that internationalization can serve as an independent variable to enhance knowledge-based advantages and profitability (Dunning, 2006; Narula, 2006, 2012; Rugman, 2009; Ramamurti, 2012; Verbeke & Forootan, 2012)

Extant discussion has thus focused on two legs of the eclectic paradigm, i.e., knowledge-based advantages and location advantages. Internationalization theory, the third leg in the eclectic paradigm, has been insufficiently discussed. Consequently, extant discussion

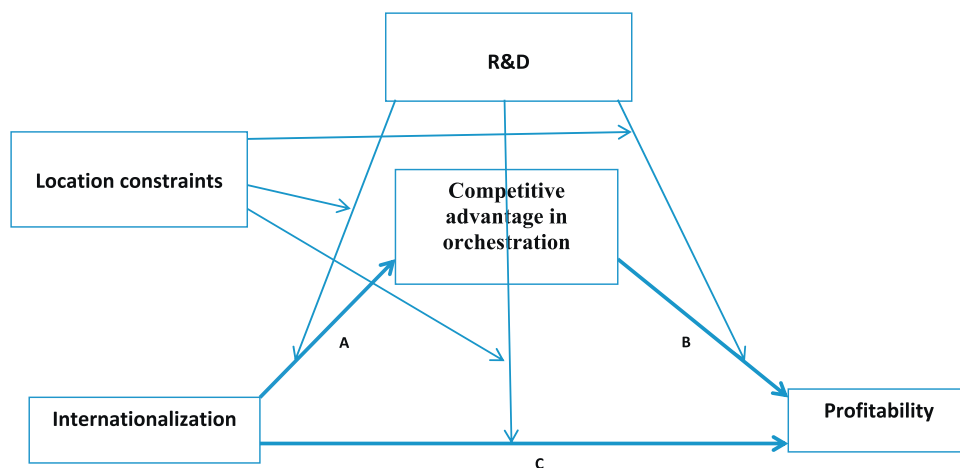


Fig. 1. Moderated Mediation Model of Internationalization and Performance.

Note: AB represents the indirect effect of internationalization on profitability through the competitive advantage in orchestration. C represents the direct effect of internationalization on profitability. Both the direct and indirect effects of internationalization on profitability are moderated by R&D in a MNE and constraints to innovation in the location where a MNE is based.

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