International Business Review 25 (2016) 1124–1135

Contents lists available at ScienceDirect

International Business Review

journal homepage: www.elsevier.com/locate/ibusrev

Outward foreign direct investment from emerging economies: escaping home country regulative voids

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ARTICLE INFO

Article history:
Received 5 February 2015
Received in revised form 7 February 2016
Accepted 19 February 2016
Available online 11 March 2016

Keywords:
Outward foreign direct investment
Emerging economies
Institutional voids
Mainstream theory
Emerging view of internationalisation
Institution-based view

ABSTRACT

The internationalisation of multinationals from emerging economies raises the question of whether mainstream theory can explain this phenomenon. We combine the explanations of outward foreign direct investment (OFDI) provided by the institution-based view and the investment development path (IDP) and suggest that the combined use of these explanations contributes to the reconciliation of the mainstream and emerging views of internationalisation. We argue that although OFDI is undertaken by firms to overcome the competitive disadvantages resulting from home country regulative voids, escapist investment is facilitated if these firms possess certain competitive advantages that help them overcome the liability of foreignness when expanding abroad. We thus expect the impact of regulative voids on OFDI to vary with the level of local firms' ownership advantages. Our analysis of OFDI flows from 29 emerging economies over 17 years (1995–2011) provides support for the direct effects of two types of regulative voids and for the three suggested moderating effects of firms' competitive advantages.

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1. Introduction

The significant increase of outward foreign direct investment (OFDI) from emerging economies over the last few decades has led to a growing body of research into the drivers of this phenomenon (Wu & Chen, 2014; Kang & Jiang, 2012; Wang, Hong, Kafouros, & Boateng, 2012). As emerging economies have different institutional contexts compared to developed economies (Gammeltoft, Pradhan, & Goldstein, 2010), this strand of literature asks whether mainstream theory is able to explain OFDI flows from emerging economies (Rugman & Nguyen, 2014), whether these theories require extension (Buckley et al., 2007; Child & Rodrigues, 2005; Cuervo-Cazurra, 2012; Ramasamy, Yeung, & Laforet, 2012), or whether new theories are needed (Kalotay & Sulstarova, 2010; Mathews, 2002, 2006).

In particular, the debate has focused on whether multinationals from emerging economies (EMNEs) invest abroad to exploit specific competitive[1] advantages (Buckley et al., 2007; Cuervo-Cazurra & Genc, 2008; Liang, Lu, & Wang, 2012; Stoian, 2013), or whether EMNEs use OFDI as a way to counteract the competitive disadvantages resulting from their limited internal resources (Child & Rodrigues, 2005; Luo, 2000; Luo & Tung, 2007; Mathews, 2002, 2006), and from operating in 'institutional voids' (Cuervo-Cazurra & Genc, 2008; Liang et al., 2012; Luo & Tung, 2007; Witt & Lewin, 2007; Yamakawa, Peng, & Deeds, 2008). Such escapist OFDI is undertaken to overcome the competitive disadvantages resulting from home country institutional voids (institutional escape) or to decrease the negative impact of home country image on firm competitiveness (discrimination escape) (Cuervo-Cazurra & Ramamurti, 2015).

Institutional voids represent contexts with either missing or inefficient and often volatile institutions (Cuervo-Cazurra & Genc, 2008; Gammeltoft et al., 2010) that lead to firm competitive disadvantages for firms. Such institutional voids relate to underdeveloped capital markets, infrastructure, intermediary markets, regulatory systems, contract enforcing mechanisms and other institutions. Extant research on the response of domestic firms to institutional voids highlights alliances with foreign firms (Siegel, 2004), geographical clustering (Lundan, 2012) and

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[1] We use the terms 'competitive advantages' and 'ownership advantages' interchangeably.

http://dx.doi.org/10.1016/j.ibusrev.2016.02.004
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increased horizontal scope in business structures (Makhija, 2004; Peng, Lee,& Wang, 2005). However, studies on OFDI as a possible response to institutional voids are scarce (JIBS, 2014).

Whilst research has begun to draw on Scott's (2002) understanding of institutions that includes regulative, cognitive and normative pillars[2] to investigate the impact of home country institutional voids on OFDI from emerging economies (Cui, Jiang, & Stening, 2011), researchers stress the need to explore in more depth the effects of various types of institutional voids on these OFDI flows (Pedersen & Stucchi, 2014) and underline the particular relevance of regulative voids in the firms' home country for OFDI (Cuervo-Cazurra & Genc, 2008; Cuervo-Cazurra & Ramamurti, 2014, 2015; Stal & Cuervo-Cazurra, 2011). Regulative voids are a particular type of institutional voids and are characterised by missing, volatile or inadequate rules and regulations that are poorly enforced or monitored. Such rules and regulations comprise, *inter alia,* legislation regarding monopolies and state aid, regulations regarding bribery, corruption and the independence of the judiciary, as well as property rights legislation, including intellectual property rights legislation (Cuervo-Cazurra & Ramamurti, 2015).

Stal and Cuervo-Cazurra (2011) examine the impact of regulative voids and pro-market reforms on Brazilian OFDI. They argue that some Brazilian EMNEs invest abroad to exploit competitive advantages resulting from pro-market reforms, whilst others relocate to tax heavens to escape their home country over-regulated market. Nevertheless, their analysis does not explore the relationship between the escape motives of EMNEs and the EMNEs' competitive advantages. Moreover, Wu and Chen (2014) find that whilst home market underdeveloped institutions enhance OFDI, volatile institutions do not increase OFDI, as a volatile home institutional environment distorts resources and prevents firms from developing ownership advantages that could be exploited through OFDI. This raises the question of what type of ownership advantages influence the relationship between regulative voids and escapist OFDI from emerging economies.

The aim of this paper is to investigate the impact of regulative voids on OFDI from emerging economies and to clarify the moderating effect of firms' competitive advantages on this relationship. We address the following research questions: How do regulative voids affect OFDI? How do firms' competitive advantages moderate the relationship between regulative voids and OFDI? We explore these questions using a sample of OFDI from 29 emerging economies over a 17-year period (1995–2011).

We argue that the underdeveloped institutions that characterise regulative voids lead to the misallocation of resources and competitive disadvantages (Cuervo-Cazurra & Genc, 2008) that EMNEs seek to counteract through OFDI. However, as suggested by mainstream theory, to escape through OFDI, EMNEs need to exploit competitive advantages, thus overcoming the liability of foreignness. In particular, the ability of MNEs to escape home country regulative voids is enhanced by the firms' *ownership advantages* developed as a result of *spillovers from inward FDI*.

Our study makes several contributions. Our main theoretical contribution is to provide a theoretical framework that extends and specifies the institution-based view (Peng, Wang, & Jiang, 2008). Specifically, our analysis extends the literature on institutional voids (Doh, Lawton, & Rajwani, 2012; Khanna & Palepu, 2010; Makhija, 2004; Makhija & Stewart, 2002) by developing and exploring in greater depth the nature and effects of one of its constituents, i.e., regulative voids, on OFDI from emerging economies. We propose that high protectionism, corruption and bureaucracy in the home market lead to resource constraints and enhance escapist OFDI. In doing so, we answer the calls for more research into the impact of regulative voids on OFDI.

Furthermore, building on Dunning's (1981) investment development path (IDP), we contribute towards reconciling the mainstream and the emerging views of internationalisation by explaining the moderating effect of a firm's ownership advantages on the relationship between escapist OFDI and home country regulative voids, which are characterised by high protectionism, high corruption and high bureaucracy. We find that the impact of home country protectionism, corruption and bureaucracy on escapist OFDI is moderated by the firm's ownership advantages based on imitating and learning from incoming multinationals. This allows us to contribute to our understanding of OFDI from emerging economies by showing that escapist OFDI is enhanced if domestic firms possess competitive advantages developed as a result of *spillovers from inward FDI*. Finally, we contribute to practice by putting forward several recommendations for managers and policy makers.

Our paper is organised as follows: After discussing our theoretical framework and developing our hypotheses, we explain the methodology and present our results. We conclude by highlighting this study's contributions to theory and practice, its limitations and areas for further research.

2. Theoretical framework

2.1. Explaining OFDI from emerging economies: reconciling the mainstream and the emerging viewe

According to the mainstream perspective, firms internationalise to exploit their firm-specific advantages in other geographical locations (Caves & Porter, 1977; Dunning, 1981, 1986; Hymer, 1976). These competitive advantages include high productivity, high efficiency, specialised know-how, availability of capital or international experience (Dunning, 1980). This perspective includes Dunning's (1981) IDP, and the IDP's propositions are partially supported by the literature on OFDI from emerging economies (Andreff, 2002, 2003).

Recently, authors have provided an alternative view (the emerging view of internationalisation). According to this view, firms internationalise to acquire competitive advantages (Child & Rodrigues, 2005; Luo, 2000; Mathews, 2002, 2006) and/or to escape the home country's weak institutions and economic underdevelopment that lead to firm competitive disadvantages (Cuervo-Cazurra & Genc, 2008; Cuervo-Cazurra & Ramamurti, 2015; Luo & Tung, 2007; Witt & Lewin, 2007; Yamakawa et al., 2008). Escapist OFDI can occur for several reasons. On the one hand, discrimination escape OFDI aims to diminish the negative impact of home country image on firm competitiveness and its operations abroad. Firms engage in OFDI to minimise firm discrimination resulting from the assumption of consumers and governments in developed economies that: (a) products from emerging markets are inferior in quality compared to those made in developed economies as a result of weaker product-safety legislation and lower technological development in emerging economies; (b) goods from emerging markets are produced by workers who are prepared to work for low wages, in unsafe working conditions and who are protected by inadequate rights; (c) EMNEs are riskier than developed economies MNEs due to poor governance and higher macroeconomic volatility and hence they should incur a higher cost of capital (Cuervo-Cazurra & Ramamurti, 2015). CEMEX' investments in Spain is a well-known example of the latter type of

[2] The cognitive pillar refers to the actors' generally shared perceptions of what is typical or taken for granted (Scott, 1995), in other words shared knowledge. This component of institutions leads to an isomorphism of activities through imitating activities that have a strong cultural support (Scott, 1995). The normative pillar defines what is appropriate or ' right' for a society and institutions such as the education system, the government and religion promote the 'correct way' of behaviour, even in the absence of legal or other sanctions.

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