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Firm-specific advantages, inward FDI origins, and performance of multinational enterprises

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ABSTRACT

Using original data on large Korean multinational enterprises (MNEs), this paper examines the impact that their firm-specific advantages (FSAs) have on performance as and when they receive inward direct investment from foreign countries. Two types of FSAs are examined: innovation capabilities measured by research and development (R&D) intensity and marketing capabilities measured by selling, general, and administrative (SGA) intensity. It is found that both FSAs affect diverse MNE performance in a non-linear U-shaped fashion, and that the home region origin of the inward foreign direct investment (FDI) moderates the curvilinear relationship between the two constructs into an inverted U-shaped one.

1. Introduction

It is well known that the competitive advantages of multinational enterprises (MNEs) are determined by the interaction of two sets of factors. First are factors internal to the firm which lead to the development of unique capabilities, so-called firm-specific advantages (FSAs). Second are external factors to the firm that offer complementary resources for the exploration and/or exploitation of FSAs in foreign markets, so-called country-specific advantages (CSAs). The nature of FSAs, CSAs, and their interaction has been developed into a basic FSA/CSA framework to analyze the activities and performance of MNEs by Rugman (1981) and is popularized in textbooks such as Rugman and Collinson (2009).

The FSA/CSA framework captures the essence of the resource-based view (RBV) of firms as suggested by Wernerfelt (1984) and Barney (1991), and internalization theory as developed by Buckley and Casson (1976, 2009). According to the RBV of firms, acquisition and accumulation of hard-to-imitate resources and capabilities will allow firms to achieve sustainable competitive advantages, translating into high performance in the markets (Barney, 1991, 1997; Day, 1994; Wernerfelt, 1984). Internalization theory also posits that MNEs are created when they internalize certain markets for intangible assets across national borders (Buckley and Casson, 1976; Hymer, 1976), and, as a result, MNEs can internalize knowledge-based resources and capabilities—either in innovation- or marketing-related activities—inside their firm boundaries in order to effectively offset additional costs from the liability of foreignness (Caves, 1996; Zaheer, 1995). MNEs thereby achieve higher performance in foreign markets (Dunning, 1973; Hymer, 1976).

In addition, the FSA/CSA framework advances on the RBV and internalization theory by highlighting country factors as strategically relevant for the performance of MNEs. It shows that MNEs need to locate their foreign business in countries where they can maximize the full benefits of exploring and/or exploiting FSAs from the internationalization process. The influence of country

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factors on MNE performance has been extensively explored in the international business literature so far in terms of host country characteristics/context/institutional changes (Allred and Swan, 2005; Aulakh and Kotabe, 2008; Christmann et al., 1999), cross-cultural differences/distance (Ambos and Ambos, 2009; Calhoun, 2002), alliance partner origins (Acquaah, 2009), and diversification strategies (Nachum, 1999; Qian and Li, 1998).

Considering that there are two dimensions in the internationalization of firms (i.e., outward and inward activities), more attention needs to be given to an *input*-oriented perspective (Hassel et al., 2003). This inward dimension of internationalization highlights the potential 'linkages' between foreign investors and domestic recipients, whereby the latter wish to build and/or upgrade their own FSAs from the firm-specific advantages (FSAs) possessed by the former, leading to the economic development of FDI-receiving host countries (Rugman and Doh, 2008). Foreign MNEs usually possess knowledge-based tangible and intangible assets—such as patents, manufacturing technology, marketing skills, trademarks, etc.—which indigenous firms usually lack. As a result, one way for indigenous MNEs to accumulate FSAs is to attract inward FDI from foreign MNEs. This provides additional resources and capabilities such as new financial capital, technology, management skills, and access to foreign markets and sources of raw materials among others (Dunning, 1994).

When indigenous firms try to build and/or upgrade their own FSAs based on the inward dimension of internationalization, the proximity between the providers and recipients of the inward FDI should be considered as an important component of CSAs. This is because direct investment from all countries is not necessarily homogeneous (Buckley et al., 2004, 2007). Different home country (or region) origins of inward FDI may create different effects on the accumulation of FSAs, and, as a result, they may have a substantial influence on the performance of indigenous MNEs in world markets. For example, Lecraw (1993) argues that the motivations of FDI vary with the geographic origin of investors. Tan and Meyer (2011) show that the shared socio-cultural backgrounds under the same country (or region) of origin facilitate the development of trust, reduce the uncertainty of economic exchanges, and enhance the legitimacy on the part of foreign investors conducting FDI in host countries. Makino and Tsang (2011) also suggest that historical ties that can be formulated within a geographic region should be considered as an additional factor when examining FDI decisions. As such, based on the inward dimension of internationalization, we can find the countries/regions which are linked to indigenous MNEs and the impact on performance.

Knowledge gaps identifiable in the literature on the relationship among the FSA-building process of indigenous firms, their attracted inward FDI, and firm performance in the markets are two-fold. First, although suggesting an important connection between FSAs and firm performance, both the RBV and internalization theory do not clearly explain the *nature* of the relationship between FSAs and firm performance, i.e., *in which ways FSAs affect firm performance in the markets*. In fact, while an extensive literature has examined the functional relationship between FSAs and firm performance, there are still no agreed results on the nature of this relationship (e.g. Delios and Beamish, 2001; Lu and Beamish, 2001; Souitaris, 1999; Sriram and Sapienza, 1991). This is due to the problem that core capabilities may turn into core rigidities and have a negative impact on overall firm performance (Haas and Hansen, 2005; Leonard-Barton, 1992). Second, the impact of country factors on MNE performance has been recognized in the now classic step-wise process theory of internationalization by Johanson and Vahlne (1977, 1990) and their Uppsala colleagues, the regionalism argument by Rugman and Verbeke (2004) and Rugman (2003, 2005), and the parallel work by Ghemawat (2007) on semi-globalization, and they have been tested from the output side rather than the *input side* of internationalization. Yet, as discussed above, indigenous MNEs strive to receive inward direct investment from foreign investors in order to build up and/or strengthen their FSAs. In fact, previous research has suggested diverse channels through which inward foreign direct investment (FDI) can upgrade the FSAs of recipient companies in host countries (e.g. Buckley et al., 2006, 2007; Caves, 1974; Peng, 2001; Urata and Kawai, 2000).

In order to fill these gaps in the literature, we investigate in this current study (1) *in which ways FSAs built in MNEs affect their firm performance in the markets*, and, (2) *whether and how the country origin of inward FDI from its home region affects the relationship between FSAs and MNE performance as and when MNEs attract inward direct investment from foreign investors to strengthen their FSAs*. Here, using government survey data on inward FDI specific to individual Korean MNEs, we examine the non-linear effects of innovation and marketing capabilities (i.e. FSAs) of these Korean MNEs on their firm performance. We then explore the manner in which the home region origin of inward FDI (i.e. CSAs) interacts with the innovation and marketing capabilities affecting Korean MNE performance. We do this in a novel way where we aggregate the individual CSAs into a regional effect. We distinguish between the CSAs in the home region of Asia-Pacific (i.e. the home region of large Korean MNEs) and those in the non-home region. We examine the extent to which this home region-specific advantage (HRSA) moderates the linkage between FSAs and MNE performance. Thereby we test for the regional effects of the improved FSAs of Korean MNEs on their performance at a company level. We approach the issue of regionality from the input side of firm internationalization by investigating the home region origin of the inward FDI that Korean MNEs receive from foreign countries.

Korea provides a good empirical basis for this analysis, because, due to the lack of financial resources and sophisticated technological advantages, internationalization through attracting foreign investors has been a prerequisite for Korean firms in the past several decades. Especially during the late 1990s, the Korean government shifted towards an inward FDI-based economic development policy from a foreign loan-based one to foster development of its national economic system after the Asian financial crisis (Lee and Rugman, 2009).

By answering how the performance of MNEs may be affected by FSAs as and when they receive inward investment from foreign countries (and regions) using a Korean sample, this study makes a number of contributions to the international business literature on MNE performance and regional strategy. A key contribution is to test explicitly for the non-linear effects of accumulated FSAs by indigenous MNEs on their performance. Although both the resource-based view (RBV) of firms and internalization theory of MNEs have consistently suggested that there is a close and substantial relationship between hard-to-replicate FSAs and firm performance, a separate but important empirical issue is in which ways FSAs affect firms' performance in the markets. This