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The role of technological catch up and domestic market growth in the genesis of emerging country based multinationals

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ABSTRACT

The paper presents a model that evaluates how upgraded technological capabilities of emerging country based multinationals (EMNCs) and an increase in the domestic market size of large emerging countries affect value chain location choices and the competitiveness of emerging country based firms versus advanced country based ones. The model shows that, even without possessing a competitive advantage in terms of technology and/or brands, EMNCs from large or rapidly technologically advancing countries can become dominant players in the global system. The model highlights the central role of firm level technological intensity and product differentiation in determining the location of value chain activities as well as defining organisational boundaries. Empirical analysis of the location choices of the world's top multinationals from large advanced and emerging countries in 2010 supports the model's predictions.

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1. Introduction

Post World War II globalisation, in terms of Foreign Direct Investment (FDI) and international trade, has been dominated by large advanced country based multinationals (AMNCs). Such hegemony was facilitated by technological advantages, well recognised brands, superior managerial practices and production efficiency, coupled with the existence of large domestic markets as a major source of demand for products and services (Dunning, 1988, 1993; Vernon, 1966, 1971).

However, the accelerated development of countries such as Brazil, India, China and Russia has resulted in a growing number of emerging country based multinationals (EMNCs) beginning to play an important role in today's global system. The increased salience of EMNCs has been widely documented in the extant literature (e.g. Bonaglia et al., 2007; Buckley et al., 2007; Dunning, 2006; Duysters et al., 2009; Goldstein, 2007; Lall, 1983; Luo and Tang, 2007; Mathews, 2002, 2006; Niosi and Tschang, 2009; Ramamurti and Singh, 2009; Sauvant, 2008; Wells, 1983).

A recurring question in this stream of literature is how can one explain the rise of EMNCs, and especially their ability to engage in FDI in advanced countries, given that many emerging country based firms lack firm-specific competitive advantages? (Amsden and Chu, 2003; Goldstein, 2007; Mathews, 2006; Nolan, 2004; Ramamurti, 2009a; Rugman, 2009). According to Dunning's Ownership-Location-Internalisation paradigm (Dunning, 1977, 1988) the possession of firm specific advantages, mainly in technological advance and brands, is a necessary condition for the emergence of the multinational corporation (MNC). This is because such advantages are needed to compensate for the liabilities of foreignness (Hymer, 1976), which imply a higher cost of doing business abroad for foreign firms. Hence, in the absence of such advantages, the rise of EMNCs seems to contradict extant explanations for the existence of MNCs.

Several answers were provided to this question, including: the superior ability of EMNCs to operate in harsh institutional environments in other developing countries (Cuervo-Cazzura and Genc, 2008; Dunning and Lundan, 2008), greater capability to adapt products to the specific demands of import protected developing markets (Lall, 1983; Wells, 1983), the leverage of home country advantages such as natural resources and cheap labour (Rugman, 2009; Cantwell and Barnard, 2008; Williamson and Zeng, 2009), access to cheap capital because of imperfections in the domestic capital market (Buckley et al., 2007) and the desire to engage in "knowledge asset seeking" in foreign markets (Dunning, 2006; Dunning et al., 2008; Goldstein, 2007; Hoskisson et al., 2000; Luo and Tang, 2007; Mathews, 2002). Yet, it still remains unclear if and under what conditions EMNCs are likely to compete successfully with AMNCs on a global scale (Ramamurti, 2009b).

The current paper utilises the global system view model (Buckley and Hashai, 2004; Casson, 2000) to postulate the conditions under which EMNCs will close the gap vis-à-vis AMNCs in

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terms of dominance in serving global markets and foreign direct investment. More specifically, the model formally analyses how upgrading the technological capabilities of EMNCs and a substantial increase in domestic market size of emerging countries, are likely to project EMNCs versus AMNCs in terms of the worldwide location and ownership of Research and Development (R&D), production and marketing activities. The model specifically highlights the role of technology intensity and product differentiation in the comparative statics of a global system comprised of EMNCs and AMNCs.

The model predicts a novel phase of globalisation where EMNCs from countries where lower production costs are maintained, and that encounter rapid technological progress or possess a large and growing domestic market become dominant competitors for AMNCs. It shows that value chain location for AMNCs and EMNCs is likely to be quite different, where AMNCs are expected to locate R&D and marketing activities primarily in advanced countries, EMNCs are expected to locate R&D and production activities primarily in emerging countries. The model further shows that greater technological intensity increases the propensity of AMNCs to locate production in advanced countries, while increasing the propensity of EMNCs to locate marketing activities in emerging countries. Greater technology intensity and product differentiation further increase the propensity of both AMNCs and EMNCs to integrate activities in-house, rather than outsource them. Empirical analysis of the location choices of the world's top MNCs from large developed and developing countries in 2010 (in Gross Domestic Product terms) shows support to these value chain location and integration predictions.

A key insight of the model is that even without possessing firm specific advantages in R&D and marketing, EMNCs from large and rapidly technology advancing countries may become dominant players in the global system. Once emerging country based firms catch up on technology (while not achieving a competitive advantage) and once their domestic market size increases sufficiently (making the interaction with consumers less costly) they become able to successfully compete with advanced country based firms.

In the next section we briefly present the literature on the rise of EMNCs. In Section 3 we build on the "global system view" perspective and present a simple model that predicts the outcome of EMNCs versus AMNCs competition in terms of value chain location and integration. Section 4 presents our data, measures and methods, and results are presented in Section 5. Insights from the model and the structure of the resulting emergent global system are discussed in the concluding sections.

2. The globalisation of EMNCs

The global system at the end of the 20th century started to emerge after the Second World War (Obstfeld and Taylor, 2002).[2] This system has been characterised by the dominance of the US, Europe and Japan in terms of military power, political influence and technological advance. Foreign investments were the engine of this globalisation phase where integrated capital markets absorbed FDI outflows led by AMNCs, reaching a peak of over US$ 2 trillion in 2007 (UNCTAD, 2009).

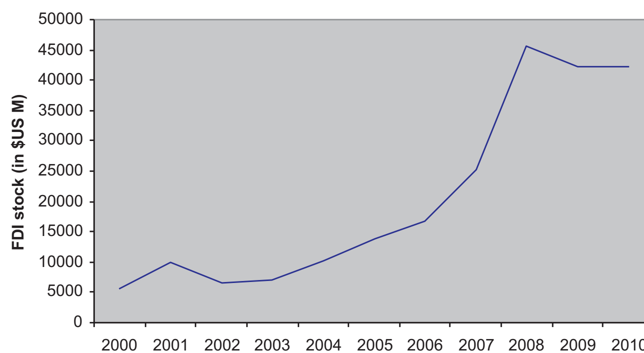

Fig. 1. Outward FDI from the BRIC countries to the United States, Japan, Germany and the United Kingdom..
Source: OECD.Stat. –

Yet, already 30 years ago a new type of multinational had emerged: emerging country based multinationals.[3] The rise of this type of multinational initially was explained by their superior ability to substitute imports in protected emerging countries in terms of scale, labour costs, skill and adapted materials (Wells, 1983). It was further argued that EMNCs often use outdated and simpler adapted technology in other emerging countries going down the ladder of the product life cycle to even less advanced countries (Ghymn, 1980; Lall, 1983). In many aspect EMNCs are still believed to enjoy the advantages of experience of operating in harsh institutional environments (Cuervo-Cazzura and Genc, 2008; Dunning and Lundan, 2008) and data indeed shows that such firms mainly establish foreign operations in other emerging countries, most often in their home region (Rugman, 2008, 2009). All in all this pattern of EMNCs investing in other emerging countries seemed to fall within the boundaries of extant FDI theories (Dunning et al., 2008).

Yet, as Fig. 1 illustrates, the outward FDI stock from large emerging countries such as Brazil, Russia, India and China (BRIC) into major advanced countries, such as Germany, Japan, the US and the UK, has increased almost tenfold in the last decade. While in terms of share out of inward FDI, FDI from emerging countries into advanced ones is still modest (about 1.2% in 2010) it is clear that a growing number of EMNCs are establishing operations in advanced countries. Multiple pieces of anecdotal evidence such as Lenovo's takeover of IBM's PC business, Tata Steel's takeover of the Anglo-Dutch Corus Steel, Jaguar, Land Rover and Tetley Tea, Cemex's takeover of large cement companies in Australia, the UK and the US provide further evidence for the growing dominance of EMNCs vis-à-vis AMNCs.

The fact that many EMNCs establish foreign operations in advanced countries seems to contradict extant international business theories. One would expect EMNCs to possess competitive advantages in terms of technology, brands or superior managerial practices (Dunning, 1977, 1988) that will compensate for their liability of foreignness (Hymer, 1976) when operating in more advanced countries. Given that many EMNCs often lack firm specific competitive advantages (Amsden and Chu, 2003; Goldstein, 2007; Nolan, 2004; Mathews, 2006; Ramamurti, 2009a,b; Rugman, 2009) alternative explanations to the rise of EMNCs were sought.

One important explanation refers to the establishment of foreign operations in advanced countries as a vehicle for knowledge

[2] Of course this process is not unique as the following quotation about ancient Rome illustrates. "...trading with Empires, picking up new farming techniques from them, receiving their diplomatic subsidies, copying their weaponry and ideologies, and organising yourself to fend off the worst excesses of domination, all pushed forward the sequential emergence of more developed economies and larger state structures in the Germanic and Slavic worlds in the two halves of the first millennium... particular groups in the periphery are able to take advantage of the opportunities opened up by the range of new contracts with an imperial neighbour, and this is precisely what we now call a globalization" (Heather, 2013: 294).

[3] The exact definition of EMNCs is not trivial (Goldstein, 2007, Section 2.1). In this paper we refer to multinationals that are managed from an emerging country headquarters as "EMNCs". We acknowledge the fact that this definition may not include all multinationals originating in emerging countries yet it captures the vast majority of such multinationals.

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