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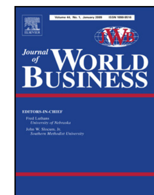

Tapping the power of local knowledge: A local-global interactive perspective

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ABSTRACT

Existing theories of international business and strategy do not fully explain how local knowledge disadvantage faced by foreign investors can be mitigated. We conducted an in-depth qualitative study into four MNCs to investigate the micro-processes of how they generated value from their dispersed sources of local knowledge in China. The results suggest an interactive model: that MNCs employed management processes encompassing three strategically interconnected efforts—global knowledge penetration, local-global knowledge blending, and local-global knowledge integration. The model highlights the interplay between global and local knowledge and challenges extant research that solely focuses on the transfer of either home-based or local knowledge.

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1. Introduction

Local knowledge is generally defined as 'knowledge that is specific to a host country' (Lord & Ranft, 2000; p. 573). It has long been recognized that location-based disadvantage, and local knowledge disadvantage in particular, significantly hinders the performance of foreign investors in a host country (Elango, 2009; Hymer, 1976; Johanson & Vahlne, 1977; Makino & Delios, 1996; Zaheer, 1995). However, there is an inadequate understanding of how such liability can be mitigated (Denk, Kaufmann, & Roesch, 2012; Luo & Mezias, 2002; Tsang, 2002). This question is especially salient in transition economies where multinational corporations (MNCs) increasingly establish their production or presence but the level of the liability of foreignness is recognized to be higher than that in developed markets (Luo, Shenkar, & Nyaw, 2002; Peng, Wang, & Jiang, 2008).

Research in international business and strategy has generated two undisputed insights about how foreign investors can overcome local knowledge disadvantage. First, foreign firms can create ownership advantage – home-based technology, production know-how, and management practices that can be transferred to host markets at low cost (Buckley & Casson, 1976; Dunning, 1993; Rugman, 1981) – thereby offsetting its 'liabilities of foreignness' (Zaheer, 1995). Studies in this stream suggest that the MNC's success in foreign markets is due in large measure to its capability for global knowledge transfer (Fang, Wade, Delios, & Beamish, 2013; Gupta & Govindarajan, 2000; Kogut & Zander, 1993). We define global knowledge as the knowledge which is developed in or sourced by the firm's home base and is then made accessible to relevant populations of host-country markets. Second, local knowledge disadvantage can be reduced by the MNC through learning and transfer of local knowledge from various local knowledge sources such as host-country subsidiaries, domestic suppliers and local joint venture partners (Li, Poppo, & Zhou, 2010; Lord & Ranft, 2000; Makino & Delios, 1996; Petersen & Pedersen, 2002; Tsang, 2002).

Although these insights have been consistently supported in empirical research (Delios & Beamish, 2001; Chang, Gong, & Peng, 2012; Scott-Kennel & Giroud, 2015; Yang, Mudambi, & Meyer, 2008), there appears to be little understanding of how global knowledge may interact with local knowledge to address local knowledge disadvantage. Yet, global and local knowledge interaction has been indicated in the international business literature. By *global and local knowledge interaction*, we mean the situation or occurrence in which global and local knowledge act upon or are dependent on each other. For example, in a study of the determinants of knowledge transfers to and from newly acquired

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subsidiaries in transition economies in Europe, Yang, Mudambi and Meyer's (2008) have found that MNCs actively engage in the management of knowledge flows in multiple directions, the implication of which is that it is inevitable for global and local knowledge to come into close contact and act upon each other within these cross-border organizations. Fang et al. (2013) have observed that various knowledge resources of the parent company and its subsidiaries interact and that such interaction is often associated with a foreign subsidiary's performance. Hong and Snell's (2013,2015) case studies of China-based Japanese multinational firms and their local suppliers have investigated the co-opetition mechanisms for subsidiaries of the MNC and their domestic suppliers to jointly develop new capabilities and knowledge that meet both home-based quality standards and changing requirements of the Chinese market, thus suggesting a mutually-dependent relationship between the global knowledge of the MNC and the local knowledge of the domestic suppliers. Undoubtedly, the academic literature has offered valuable insights into global and local knowledge interaction within the MNC and beyond its certain boundaries, but as yet there has been inadequate empirical research to explore the detailed processes of local and global knowledge interaction at the micro level and their consequential nature in relation to mitigating local knowledge disadvantage.

This paper attempts to address that gap. We focus on the research question: What are the micro-processes of global and local knowledge interaction employed by MNCs to overcome local knowledge disadvantage in a transitional host economy? We present an embedded multiple case study that examined the micro-processes of how MNCs generated value from their dispersed sources of local knowledge in China. We observed how local knowledge and global knowledge interacted during the MNC's local knowledge management processes and investigated why such interactive processes reduced the MNC's local knowledge disadvantage.

2. Theoretical background

2.1. The concept of local knowledge

Local knowledge is what Johanson and Vahlne termed 'market-specific knowledge' of the host country. It ranges from explicit information to tacit and experientially-based forms of knowledge essential for foreign investors to deal with the intricacies of different cultures and socioeconomic systems (Lord & Ranft, 2000; Makino & Delios, 1996; Meyer, Mudambi, & Narula, 2011). Local knowledge may be internally generated by the MNC's subsidiaries (Lord & Ranft, 2000; Rabbiosi & Santangelo, 2013) or resides in the periphery of the MNC's local social networks (Hong, Snell, & Easterby-Smith, 2009; Tallman & Chacar, 2011). Compared to global knowledge transferred to host markets (e.g. technology and production processes) local knowledge is less codified, highly dispersed, wide-ranging, and more interdependent with its social context, and thus more difficult to capture and transfer (Li & Scullion, 2010).

2.2. Local knowledge disadvantages

In his seminal work, Hymer (1976) introduced the concept of location-based disadvantages faced by foreign investors. He noted that foreign firms would incur costs of gaining legitimacy in and acquiring market information about their host markets. Subsequent theoretical and empirical works have attempted to substantiate the concept. Zaheer (1995), for example, compared the performance of 24 locally- and foreign-owned foreign exchange trading rooms of major Western and Japanese banks in New York and Tokyo and found that the locally-owned trading rooms did indeed outperform the foreign-owned trading rooms. She coined the term 'liability of foreignness' to explain 'the costs of doing business abroad that result in a competitive disadvantage for an MNE subunit' (1995, p. 342).

Internationalization process theorists (Inkpen & Beamish, 1997; Johanson & Vahlne, 1977) have attributed much of such liability to a lack of local knowledge of social, political and economic conditions. As Johanson and Vahlne (1977, 2009) have pointed out, the lack of understanding of the differences between countries is an important obstacle to strategic decision making and thus hinders the development of international operations. Local knowledge disadvantage faced by foreign investors often limits their abilities to succeed abroad (Lord & Ranft, 2000; Makino & Delios, 1996). In emerging markets, such difficulties are often exacerbated by the rapid pace of political and socioeconomic changes (Aulakh & Kotabe, 2008), resulting in ambiguities or a lack of transparency (Peng et al., 2008). Some researchers (Harvey, Speier, & Novicevic, 1999; Li et al., 2010) argue that the level of local knowledge disadvantage in emerging economies is higher than that in developed markets due to complex and rapidly changing political and economic conditions. Therefore, the MNC's ability to reduce local knowledge disadvantage, especially in emerging markets, eventually leads to the firm's competitive advantage.

2.3. Conventional approaches to mitigating local knowledge disadvantage

2.3.1. The global knowledge transfer approach

Internationalization has been conceptualized as a process of transferring an organization's home-based knowledge that underlies its technology or primary business activities (Buckley & Casson, 1976; Kogut & Zander, 1993). The vast majority of research on strategies for mitigating local knowledge disadvantage therefore focuses on how the MNC's home-based advantages compensate for its liabilities of foreignness (Zaheer, 1995). Studies in this research stream suggest that MNCs are superior knowledge systems that facilitate the transfer of home-based knowledge across borders (Gupta & Govindarajan, 2000). For instance, in their influential work, Kogut and Zander (1993) studied the superior efficiency of the MNC as an organizational vehicle to create and transfer home-based knowledge for its worldwide subsidiaries. This work has much to offer in its focus on global knowledge transfer. However, taking a resource-based perspective, a number of scholars argue that a firm's advantage supported by resources in its home-based country may lose its value in a host business environment and thus the location-based disadvantages that significantly affect its host country performance should not be ignored (Cuervo-Cazurra, Maloney, & Manrakhan, 2007).

2.3.2. The local knowledge learning and transfer perspective

The notion of local knowledge disadvantage has intrigued a number of authors that have viewed internationalization as a dynamic process of organizational learning in host markets (Doz, Santos, & Williamson, 2001; Johanson & Vahlne, 1977). Johanson and Vahlne (1977), for example, developed a model of the internationalization process of the firm which particularly emphasized the gradual acquisition of knowledge about foreign markets and operations. In this model, local knowledge can be gained mainly through the firm's experience in its host market. Lord and Ranft (2000) investigated the extent and determinants of internal local knowledge transfer. By analyzing over 100 divisions of diversified MNCs entering new host countries in their survey-based study, the authors found that the extent to which local

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