THE RISE OF MULTINATIONALS FROM EMERGING ECONOMIES: A THEORETICAL APPROACH

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Abstract.

The waxing of multinational firms from emerging economies (EEMNEs) could hardly be foreseen before 1980. Today one can state, with the wisdom of hindsight, that clear signs of change only became apparent after 1990. This explains why most of the literature devoted to this topic pertains to the last two decades. Studies so far have highlighted, besides well-known, repeatable elements, certain unusual behavioral aspects that do not fit existing patterns and consequently, cannot be explained with the aid of known paradigms.

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1. The waxing of East Asia laid the foundation for the growth of emerging markets multinationals

The 1980s brought about significant changes to global business: a number of companies from a group of so-called fast-growing economies, also called "newly-industrialized economies" (NIEs), mainly located in Latin America and South-Eastern Asia strived to acquire strong positions on their domestic markets, enjoying lavish protectionist support by their governments. As growing amounts of foreign direct investment (FDI) flew inward, the

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fledgling national champions would supply foreign MNEs with complementary factors (cheap labor, raw materials, intermediate products etc.). Although, in this early phase, the respective emerging economies were still net importers of most processed industrial and consumer goods, the incoming FDI flows enabled their domestic companies to diversify their production and grow ever stronger, in symbiosis with foreign multinationals operating on their turf. Later on (the 1980s and first half of the 1990s), the said national champions, backed by export-oriented governmental policies and benefiting by the growing openness of western markets, gradually became competitive exporters and international investors, putting their comparative advantage to good account, albeit their industrial specialization remained confined to labor-intensive operations, characteristic to the lower end of the value-chain. Most importantly still, the business deals with western partners allowed them to benefit by technological spillovers and intensive learning-by-doing practices, thus accumulating technological know-how as well as financial and managerial expertise. Foreign investments can be a valuable source of innovation and technological spillovers, especially through "entrepreneurial activity by individuals leaving a foreign-owned affiliate, to establish their own business". (Meyer 2004)

As a result of the developments depicted above, beginning with the second half of the 1990s a number of emerging economies that had traditionally hosted foreign investors gradually became sources of foreign direct investments themselves. A growing number of companies headquartered in these countries have steadily expanded internationally, climbing up, slowly but decidedly and somewhat stunningly, international rankings. Consequently, the respective countries became home to full-fledged multinational companies (MNEs), capable to compete against western multinationals on the world markets. Shedding some light on certain peculiar aspects of this process constitutes this paper's main goal.

2. The ascent of EEMNEs through the prism of mainstream theory

Why does capital travel across national boundaries in the first place? International capital mobility is a deviation from the rigid framework of the factor endowment theory, which assumes capital as being immobile among countries. But deviation doesn't mean rejection. Since the 1940s, when Leontief's paradox cast a fist doubt upon Heckscher-Ohlin model, theorists endeavored to accommodate the international trade theory with capital

mobility. A model by Mundell (1957) for example, still based on neoclassical-type assumptions (production functions are linear and homogenous) provides an answer: the existence of trade barriers in certain countries will act as a powerful incentive for producers worldwide to transfer capital into the respective countries. The explanation is straightforward: impediments to trade will raise the marginal product (and implicitly, returns) of factors used intensively by the protected industries (which are almost invariably in competition with imports). In conclusion, under persisting trade restrictions, liberalization of capital movements will not change the size of world production but merely its international distribution: output will increase in locations capital is bound for and decrease in the investors' home-countries.

From a broader conceptual perspective, the phenomenon under consideration, for all its peculiarities, doesn't seem to be in contradiction with the mainstream international trade and investment theory. Considering the product life-cycle hypothesis for example, the EEMNEs' expansion, which is a direct implication of the increase in outward investment from emerging economies can simply be viewed as a natural prolongation of the path described by Vernon (1966). The last stage of the path is "an advanced stage in the standardization of some products"; therefore, the theory goes, "the less-developed countries may offer competitive advantages as a production location".

In conformity with the above prediction, in the last stage of the international product-cycle, companies from developing countries will become foreign investors themselves, venturing large amounts of capital abroad and setting up affiliates in other countries. This is precisely what happened after 2000. Having gained the upper hand at regional level (due to large investments, during the 1990s, in less developed neighboring countries) the fledgling EEMNEs continued to expand in other more remote regions, mostly through foreign acquisitions, thus growing strong enough to challenge the incumbent multinationals on world markets.

From a narrower perspective, the neoclassical approach, for all its intuitive power has little relevance in respect of foreign direct investment and multinational enterprises' behavior, especially in the context of globalization, when markets are imperfect and a significant portion of world trade is intra-firm. Under such conditions, direct foreign investment is hardly related to differences among countries in respect of capital returns or other secondary determinants such as "risk diversification or tax avoidance", as Morck and

Yeung (1991) emphasized. Other motives such as share-price maximization or access to low-cost inputs were revealed to be much stronger determinants of investing abroad. Helpman (1984) focused on the ability of firms to exploit cross-country differences in factor prices by shifting activities to the cheapest locations.

Regarding the connection between trans-nationalization and shareholders' returns, there is evidence, in the literature of the 1980s and 1990s, that the broadening of firms' international networks increased their market value. Fatemi (1984) shows that multinationals usually get abnormal returns during the period prior to the initial foreign diversification due to "markets' assessment of (possible) higher profits and lower degree of riskiness..." Following the same line of reasoning, Kim & Lyn (1986) make use of Tobin's q to investigate the determinants of the excess market value of multinational corporations, emphasizing a positive relationship between the market value of the firm and the degree of international involvement. When foreign diversification takes the form of mergers and acquisitions (M&A), potential results for the acquiring firm are synthesized by Kale (2006): synergistic gains due to cost reduction on account of scale or scope economies; access to new and valuable resources or capabilities from the acquired firm; value creation by improving the performance of the latter.

With reference to home-country market structures that facilitate international investment, Caves (1971) points to "oligopoly with or without product differentiation". The main driver of horizontal investment is ownership of a special asset such as "knowledge fundamental to the production of a profitably saleable commodity" while vertical integration will most likely take place in less-competitive raw-materials industries, where control of a backward production stage may diminish or eliminate procurement uncertainty. As concerns the effects of firms' international integration (horizontally or vertically) upon trade patterns, they have been analyzed by Errunza, Senbet (1980) Doukas, Travlos (1988) and Helpman (1985). Extensive modeling has also been carried out in an attempt to quantify the impact of knowledge-based services (Carr et al. 2001), similarity of countries (Markusen 1995), trade in intermediate inputs (Markusen 2004) and other factors.

A complete review of the theory of international investment and multinational firms should not omit to mention the well-known "eclectic" or "ownership-location-internalization (OLI)" paradigm. Despite criticisms, the

OLI approach has incontestable merits: firstly, it argues foreign investments yield benefits that offset their inherent risks, called "liabilities of foreignness" (Zaheer 1995); secondly, it is a theoretical synthesis of the "three main forms of international production: market seeking, resource seeking and efficiency seeking". (Dunning 1988) Thirdly, the OLI paradigm generated a new, broader concept: investment developing path (IDP) according to which, "a country's propensity to engage in outward direct investment, or be invested in by foreign firms, will vary according to (i) its stage of economic development, (ii) the structure of its factor endowments and markets, (iii) its political and economic systems, and (iv) the nature and extent of market failure in the transaction of intermediate products across national boundaries". (Dunning 1988)

The above elements show that the existing theoretical framework is comprehensive enough to explain most of present-day North-South capital flows. Actually, the only difference is that the global finance is now a two-way street: capital travels in both directions. The theory that explains financial transfers from the core to the periphery of the world economy is good enough to explain movements in reverse, from the periphery to the core. A special theory for the EEMNEs is therefore, not accounted for, at least for now.

3. Recent theoretical approaches

Admitting history does repeat itself, a naturally-arising question is: to what extent can the contemporary trans-nationalization process that is underway in emerging economies be likened to the one experienced by multinationals from developed countries (hereinafter called "Developed Countries Multinational Enterprises" – DCMNEs) in respect of main determinants that lie behind (foreign markets penetration, economies of scale, acquisition of technologies, governmental policies etc.) as well as means of accomplishment (financing, technological capabilities etc.)?

Companies from emerging economies could not have become full-fledged global players had they not been backed financially and institutionally. Business groups have had an important role in this respect. The business group concept generally refers to a group of firms that are closely intertwined without being utterly integrated in a single entity. According to Guillén (2000) he group's chief characteristic is "the capability of combining foreign and domestic resources-inputs, processes, and market access – to repeatedly enter new industries".

Factors underlying the formation of business groups in emerging economies were revealed to be basically the same as those that had acted in developed countries. An important factor leading to the formation of business groups is the existence of informational imperfections, which can impede the generation and allocation of resources by financial markets. Under such circumstances, groups of related or unrelated businesses not only secure better access to financial resources by "operating internal capital markets" but also can diminish the principal-agent problems that might arise (Ghemawat, Khanna 1998). Another factor is the extent to which the firm's organizational structure "allows it to share its existing strategic assets (...) between divisions in an efficient manner", to enhance profitability. (Markides, Williamson 1996) From this resource-based perspective, one must distinguish between related diversification, which clearly meets this goal (by focusing on the exploitation of certain technologies and connected activities) and unrelated diversification, which is based on different considerations. However, a positive relationship seems to exist "between firm performance and the extent of unrelated group diversification". (Khanna, Palepu 2000)

The conventional theory is no less useful in explaining differences. If treated generically, the development of business groups in emerging economies during the last decades diverges from the way it had occurred in developed countries in certain respects, e.g. the reasons for firms' joining together in conglomerates. In emerging economies, conglomerates "did not grow out of a search for financial diversification, but instead grew out of the ability to set up new business ventures across a variety of industries quickly and at low cost". (Guillén 2000) In other words, business groups in emerging economies tend to diversify their portfolios in order to hedge against technological risks (due to their technological obsolescence and lack of world-class products) rather than financial risks as it happens in developed countries. Other authors (e.g. Amsden 2009) indicate the earlier age as an advantage for business groups in emerging economies relative to those headquartered in developed countries: the fact that business groups in developing countries are relatively younger makes them "free from bureaucracy at the top while enjoying professional management at the bottom and middle". Clearly, this gives them an edge over foreign-owned firms too.

Another divergence point is the role played by the state. Actually, business groups' formation has always and everywhere been influenced by the type of relations existing between the state and the society as a whole; only, in

emerging markets this type of influence has been relatively stronger. While in the west capitalism has almost always evolved under the hallmark of liberalism (implying a net distinction between states' and private sector's interests), the recent transition process occurring throughout the developing world is characterized by a much higher degree of states' participation and control over private businesses. As Francis (2001) notes, in many such economies "states and markets are enmeshed: they overlap and interpenetrate in ways that make it hard to draw firm boundaries between them". An extreme case is China, where the state-owned banking system still funnels most bank credit to the public sector (Edwards, 2007). The launching by Beijing of the "go global" policy encouraged state-owned enterprises to become global multinationals. The state provided them with hard assets, capital, intellectual property etc. at lower prices than the prevailing value of these assets on world markets. (Williamson, Zeng 2009) The model was adopted by the Indian government quickly after, and extended to private firms as well.

Just like Indian business groups, Korea's sizable domestic conglomerates (chaebols) also pursued the objective of overcoming market imperfections and scored high results in respect of affiliated companies' profitability (Chang & Choi 1988). One explanation for Korean chaebols' success resides in their proved expertise in transformational leadership (Shin & Zhou 2003). In more opened economies like Singapore and Malaysia, policies were developed "to attract large foreign multinational corporations and encourage clusters of activity to develop around them" (Stiglitz, Charlton 2005).

In conclusion, ignoring governments' involvement (stronger or weaker) as well as the special treatment enjoyed by state-owned enterprises, there are institutional and financial structures that lie behind firms from emerging economies in their efforts to internationalize their activities. Yiu et al. (2007) identify two types of such networks that foster EEMNEs in their venturing abroad: business networks and institutional networks; they act as substitutes for external markets, financial capital and entrepreneurial and management know-how.

3. Conclusions

The contemporary development of multinational enterprises from emerging economies can be considered, from many points of view, a sui-generis phenomenon; its novelty notwithstanding, it does not deviate sensibly from mainstream theory predictions. On the other hand, the process has its

idiosyncrasies; there are certain differences from the traditional pattern in respect of objectives, driving forces and means of fulfillment.

The international expansion of firms from the developing world is going on unevenly. Firstly, empirically, one can easily notice that the global picture is polarized and contrasting: most of the new multinationals are concentrated in only a small number of home-countries. Secondly, the process is firm-, industry- and country-specific: often, firms originating in certain home-countries perform differently as compared to firms originating in other home-countries; in certain industries, the expansion process is going on faster than in others.

There are domains and geographical locations that are most intensely targeted by the new players; in these particular domains, the new players seem to be crowding out the old ones. At the same time, certain domains and locations are still hardly accessible to the new comers, for various reasons. In the domains where multinationals from emerging economies are advancing most rapidly, the latter will be likely to catch up with or even outperform their western rivals in terms of size, market leverage, internationalization, competitiveness etc. How fierce and how close is the clash going to be is a matter of widespread concern today.

4. References

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