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COMMENTARIES

WHAT IS REALLY DIFFERENT ABOUT EMERGING MARKET MULTINATIONALS?

RAVI RAMAMURTI*
Center for Emerging Markets, Northeastern University, Boston, Massachusetts, U.S.A.

'The multinationalizing trend (is) widely recognized as similar in nature irrespective of the nationality of the parent company.'—Raymond Vernon (Wilkins, 1986: 202)

INTRODUCTION

As growth has picked up in emerging markets and slowed in advanced economies, firms everywhere have had to rethink their global strategies. Developed country MNEs (DMNEs) have had to gear up to exploit new opportunities and resources in emerging markets, and emerging market firms have had to figure out how to take advantage of opportunities and resources in the rest of the world. The article in this issue by de la Torre and Chacar (2012) looks at the first kind of challenge, through an empirical analysis of DMNE responses to regional integration in Latin America, while that by Madhok and Keyhani (2012) looks at the second kind of challenge, through a conceptual analysis of how and why emerging market MNEs (EMNEs) internationalize.

In this commentary, I will focus on the second kind of challenge, asking specifically whether existing theories, developed principally from studying DMNEs, are adequate to explain the behavior of EMNEs. In the literature, there are two extreme views of this question: one is that EMNEs are a new species of MNEs that can be understood only with new theory (Mathews, 2002); the other, mirroring Vernon's quote above, is that existing theory, such as the OLI model, is quite adequate to explain EMNEs (Narula, 2006). I suspect the truth is somewhere in between and that the real challenge is to discover which aspects of existing theory are universally valid, which aspects are not, and what to do about the latter.

One way to discover areas in which existing theory is inadequate is to look deliberately for situations in which reality appears to be at odds with it—in other words, to look for situations in which the behavior of EMNEs appears to be strange or inexplicable based on what we know about DMNEs. Having identified such situations, one can strive to explain them and hope eventually to develop better theory. I will identify two such puzzles in the discussion that follows.

PUZZLE NO. 1: MULTINATIONALS SANS OWNERSHIP ADVANTAGE?

The first puzzle is why emerging economies produce MNEs at all. Given their economic and technological backwardness, it can be argued that they ought not to do so. As poor countries, they are expected to import capital, including foreign direct investment (FDI), rather than export it. They are expected to go through years of inward FDI before becoming

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*Correspondence to: Ravi Ramamurti, Center for Emerging Markets, Hayden 309, Northeastern University, 360 Huntington Ave., Boston, MA 02115, U.S.A. E-mail: r.ramamurti@neu.edu

prosperous and competitive enough to produce MNEs of their own (Dunning and Narula, 1997), rather than spawn MNEs while still poor, as China and India have done. More importantly, a bedrock principle of international business (IB) theory is that to become an MNE, a company must possess significant 'ownership advantages' that can offset its disadvantages in competing abroad (Dunning, 1988). Yet, on the surface, EMNEs seem to lack the technology, brand, or management advantages of DMNEs. Madhok and Keyhani (2012) characterize EMNEs as having only 'ordinary resources,' by which they mean 'resources that have traditionally not been considered to be the source of extraordinary rents as is the case, for instance, for technology or brand, which are argued to underpin a monopolistic firm-specific advantage' (Madhok and Keyhani, 2012).

How then, is one to explain the surge of EMNEs in the last decade? I will consider two unsatisfying explanations and three promising explanations for this puzzle.

Unsatisfying explanations

One unsatisfactory 'explanation' is that EMNEs simply do not possess ownership advantages. Their internationalization is seen as the result of exploiting home country comparative advantages, such as cheap labor or natural resources, not firm-specific ownership advantages (Rugman, 2009). But such location advantages cannot be the foundation of long run success, because they are 'common to all firms located in a given country' (Lessard and Lucea, 2009: 283). If this explanation is correct, the EMNE trend should fizzle out because of its weak competitive foundations. Five or 10 years ago, such a prediction might have been held in abeyance, but it is hard to do so today, as EMNEs have gained steam rather than sputtered. In 2010, emerging markets accounted for 25 percent of global FDI flows, compared to only 6 % in 2001, and individual EMNEs have gained muscle in many industries (see, for example, Boston Consulting Group, 2011).

A second interesting but unpersuasive explanation is that EMNEs internationalize to obtain the ownership advantages they lack (e.g., Mathews, 2002; Madhok and Keyhani, 2012). This argument is sometimes referred to as the 'springboard theory' of internationalization (Luo and Tung 2007). While there is considerable evidence that EMNEs venture abroad in search of valuable technologies or brands, it is quite another thing to argue that they do so without ownership advantages *ex ante*. Anyone making this argument carries the burden of showing why a time-tested tenet of the OLI model—i.e., that firms must possess ownership advantages *before* they can internationalize—is not applicable to EMNEs. This has yet to be done convincingly.

More promising explanations

Turning next to promising explanations, the first one is that EMNEs do possess ownership advantages, but these are *different* from the ones we have been trained and conditioned to see in DMNEs (Ramamurti, 2009a: 402–410). The fact that many EMNEs have market capitalizations in the tens of billions of dollars should give one pause—could such firms really not possess ownership advantages? Dunning himself was open to the idea that ownership advantages could take other forms besides cutting-edge technology or global brands, and he believed at least some EMNEs had valuable ownership advantages (Dunning, Kim, and Park, 2008). Among the ownership advantages attributed in the literature to EMNEs is their deep understanding of customer needs in emerging markets, the ability to function in difficult business environments, their ability to make products and services at ultra-low costs, their ability to develop 'good enough' products with the right feature-price mix for local customers, and so on (see Cuervo-Cazurra and Genc, 2008; Govindarajan and Ramamurti, 2011; Guillen and Garcia-Canal, 2009; and Ramamurti, 2009a).

What we need is an open-minded, thoughtful, and empirically grounded search for the ownership advantages of EMNEs, similar to that which unearthed the ownership advantages of DMNEs (Ramamurti, 2009b). We need to understand better which advantages can help with successful internationalization, which ones cannot, and why. For instance, one of the advantages of Chinese state-owned firms is their access to cheap capital, which has sometimes financed their internationalization (Buckley *et al*., 2007). Should this be regarded as an ownership advantage or not? Madhok and Keyhani (2012) regard the ability of EMNEs to do things at low cost as a weak form of ownership advantage, but would we regard Wal-Mart's capabilities in low-cost retailing a weak ownership advantage? *Prima facie*, it is not obvious why some advantages are more precious than others or why some conventional ownership advantages, such as brands or marketing prowess, are readily accepted as being precious.

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Table 1. Share of selected countries in worldwide stock of outward FDI, various years

Region/country	1914	1969	1980	1990	2009
Europe[#]	93%	43.2%	41.1%	49.5%[#]	56.0%[#]
U.K.	50%	16.2%	14.1%	12.8%	8.7%
France		na	4.2%	6.1%	9.1%
Germany	43%	na	7.5%	8.5%	7.3%
Netherlands		na	7.4%	6.0%	4.5%
United States	6%	55%	37.7%	24.3%	22.7%
Japan	0%	1.3%	3.4%	11.2%	5.6%
Emerging markets[@]	0%	0%	12.7%	8.3%	15.9%
Worldwide OFDI stock (US $ billion)	n.a.	n.a.	571	1,791	18,982

Source: Adapted from Aharoni and Ramamurti (2011: 116), except for 2009 data, which are from UNCTAD (2010: *10*172-176).
[#]Europe's share fell secularly from 1914 to 1980, but began to reverse course because of growth in intra-EU FDI after the Single European Act of 1986 and the creation of the euro. Here, Europe does not include transitional economies, such as Hungary, Poland, the Czech Republic, or the Baltic states, but includes what UNCTAD calls 'developed Europe,' e.g., Switzerland.
[@]Reported as 'developing economies' in UNCTAD's FDI statistics. Following the same source, 'emerging markets' includes high-income countries such as Hong Kong, Taiwan, Singapore, and Korea.

A second plausible (and partial) explanation for puzzle No. 1 is that DMNEs have more potent ownership advantages because they have had more time to accumulate capabilities. In other words, EMNEs and DMNEs are in different stages of evolution as MNEs (Ramamurti, 2009a: 419–420) and with time, EMNEs may augment and enhance their ownership advantages to become more like DMNEs (Lessard and Lucea, 2009: 290–301). The observed differences in ownership advantage between DMNEs and EMNEs may, thus, simply reflect differences in their evolution as MNEs rather than differences stemming from country of origin.

In this context, it is useful to remember that MNE theory has been heavily influenced not just by Western experience—a fact that is widely recognized—but also by studies of mature MNEs—a fact that is *not* as widely recognized (Ramamurti, 2009b). When the Academy of International Business was born in the U.S. in 1959 and its principal organ, the *Journal of International Business Studies*, was first published in 1970, Western European and U.S. firms had already globalized for several decades (see Table 1). Therefore, it was natural for pioneers of the IB field to focus on mature MNEs, leaving it to historians to investigate how Western firms became MNEs in the first place. EMNEs, on the other hand, are 'infant MNEs' involved with early-stage internationalization. They provide us a wonderful opportunity to study internationalization as it unfolds and glean insights about causation that might be missed in retrospective historical research.

Failure to adjust for stage-of-evolution differences can lead to misleading conclusions about the ownership advantages of DMNEs versus EMNEs. A good example of this is the oft-stated point that EMNEs, unlike DMNEs, do not possess strong global brands. However, this difference simply reflects the fact that DMNEs have invested in brands for decades, whereas EMNEs have only begun to do so. Coca-Cola did not have a global brand when it began to internationalize; it did so only after years of brand investment in several countries. Indeed, how could any firm have global brands to begin with, given that brands are location-bound assets that have to be replicated in each new market? Yet it is not unusual for IB researchers to assume that DMNEs always possessed the ownership advantages they possess today.

A third plausible explanation for puzzle No. 1 is that EMNEs go abroad to obtain technologies and brands *primarily for exploitation in their home markets, not abroad*. For firms from large, high-growth markets, such as China, Brazil, or India, this may make strategic sense. When EMNEs from these countries acquire companies abroad, they may appear to be engaging in market-seeking internationalization when, in fact, they are engaging in strategic asset seeking. The liability of foreignness problem is more severe in the case of market-seeking internationalization and, therefore, ownership advantage is more of a necessity in that situation than it is for resource-seeking internationalization. One interesting twist here is that after obtaining foreign technology and integrating it with local capabilities for

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exploitation at home, EMNEs may venture out again—this time with market-seeking intent—but also with greater ownership advantages (for fascinating examples from China, see Williamson, 2011).

PUZZLE NO. 2: MULTINATIONALS THAT INTERNATIONALIZE IN 'WRONG' WAYS?

The IB literature has a few tenets about how firms should internationalize, as articulated in the stages model of internationalization (Johanson and Vahlne, 1977) or the product cycle hypothesis (Vernon, 1966, 1979). According to the former, firms internationalize gradually, with learning between stages of expansion and increasing commitment to host countries if things go well. Firms are also assumed to expand first to countries similar to the home country before going to dissimilar countries. According to the product cycle hypothesis, FDI flows from more-developed to less-developed countries, not the other way around.

At various times, EMNEs appear to have violated some or all of these core tenets, making it appear that they internationalize in 'wrong' ways. It has been argued that EMNEs internationalize at a much faster pace than the stages model would suggest (Mathews, 2002; Guillen and Garcia-Canal, 2009; Madhok and Keyhani, 2012). At other times, EMNEs have targeted countries in the 'wrong' sequence, that is, they have expanded into physically or economically distant countries before entering more proximate and similar countries (Ramamurti, 2004). Particularly puzzling has been the propensity of EMNEs from some countries to invest more in developed countries (South to North) than in other emerging economies (South to South). It has also been argued that EMNEs use high-commitment choices, such as mergers and acquisitions (M&A), to enter new markets, rather than beginning with low-risk, low-commitment options, such as using sales agents or sales subsidiaries (Madhok and Keyhani, 2012).

Unsatisfying explanations

Based on their speed of internationalization, choice of target countries, and high reliance on M&A as the mode of entry, it might appear that EMNEs are not conforming to mainstream IB theory. Mathews (2002: 12) speaks of the 'novel strategies and organizational forms' of EMNEs, and he notes that they 'internationalized very rapidly. It was as if they executed a 'gestalt switch' from domestic to global player—even if their actual pattern of internationalization was incremental' (Mathews, 2002: 220) He goes on to offer an alternative model to explain EMNE internationalization, which cleverly uses the same initials as the OLI framework (but which stands for outward orientation, linkage/leverage, and integration). Madhok and Keyhani (2012) explain the South to North FDI of EMNEs and their propensity for M&A as resulting from their 'emergingness,' that is, from the disadvantages of being from emerging markets and needing to catch-up quickly with DMNEs. Others note that these elements of EMNE internationalization set them apart from MNEs that came before, but offer no explanation for the differences.

I wonder if these explanations are too quick to attribute the 'anomalous' behavior to the emerging market origins of EMNEs without considering alternative explanations that may be unrelated to nationality.

More promising explanations

Let us consider some of the alternative explanations of puzzle No. 2. Take the question of rapid internationalization by EMNEs. This may well be the result of the global economic context in which EMNEs have been internationalizing—one in which the world has become flatter and in which industries have been deverticalized, making it easier for firms to obtain the resources and help they need to internationalize (Williamson and Zeng, 2009). Support for this viewpoint is provided by the fact that firms in developed countries have also sped up their internationalization in recent years, witness the 'born global' phenomenon (Knight and Cavusgil, 2004). In other words, rapid internationalization by EMNEs may be a reflection of changes in the global business environment rather than any innate organizational trait of EMNEs. The IB literature does not pay sufficient attention to 'period effects' of this sort—i.e., changes in global conditions that may significantly lower or raise the costs and risks of internationalization.

A second promising explanation for puzzle No. 2 is that EMNEs invest in countries that are physically or economically 'distant' because their strategies are based on exploiting differences rather than similarities across countries (Ghemawat, 2007), a prime example being EMNEs that engage in labor cost arbitrage. Because MNE theory is overly influenced

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by DMNE experience, it has not paid attention to the case of supplier firms in low-wage countries that forward integrate into developed countries to move up the value curve or to get closer to customers, as caricatured in Acer's 'smiling curve' (Bartlett and Ghoshal, 2000). However, it is happening on a larger scale now, because of the integration of megaeconomies with plenty of cheap labor. The point is that South to North FDI is not surprising in these cases, and it is also unsurprising that this option would not have appeared in the stages model, which emerged in the context of FDI by firms from rich countries, mostly investing in other rich countries.

Two other generic strategies for internationalization can also result in South to North FDI by EMNEs—both determined by the nature of the EMNE's industry. One is the case of cross-border vertical integration in natural resource industries, either by firms searching for downstream markets or firms searching for upstream supplies. In either case, part of the FDI may go to developed countries. In fact, a very substantial part of South to North FDI by BRIC firms has been in such industries. There is nothing new or surprising here compared to the historical experience of European, American, or Japanese firms in the same industries (Vernon, 1983).

The other strategy that results in South to North FDI occurs in industries that have matured in the developed world, but have been booming in emerging economies—industries such as cement, steel, chemicals, beverages, processed foods and meats, PCs, auto parts, etc. EMNEs, acting as 'global consolidators' (Ramamurti and Singh, 2009: 140–146), build scale through horizontal expansion and obtain advanced technologies through acquisitions in developed countries. Because the industries are mature or declining in the developed world, it stands to reason that, in those countries, EMNEs prefer M&A deals to greenfield investments, which would only add to the capacity glut.

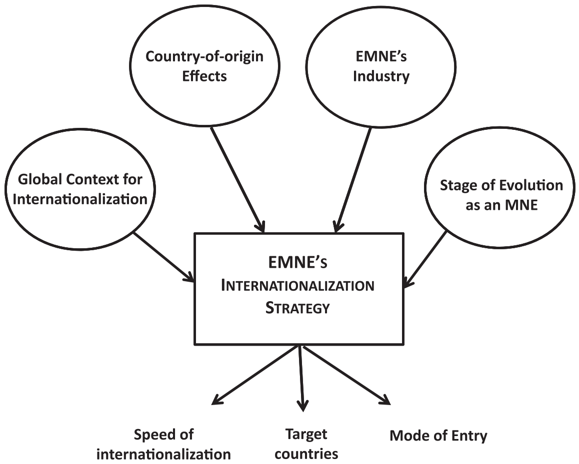

Figure 1. Determinants of EMNE internationalization

CONCLUSION

The notion that firms must have ownership advantages before they can engage in market-seeking internationalization seems to hold up well even for EMNEs. However, we must be open to the possibility that EMNEs have different ownership advantages than DMNEs, reflecting the distinctive conditions of their home market. *Prima facie*, there is no reason to believe these ownership advantages are less valuable or special than those of DMNEs, especially when applied to emerging markets, which are now the world's growth engines. We do need more research into what makes an ownership advantage valuable or special, which ownership advantages are transferable to other countries, and 'how much' ownership advantage a firm needs to offset the liabilities of foreignness. We also need more research on how the home country context shapes the ownership advantages of all firms, including EMNEs.

A second conclusion is that we must not assume EMNEs behave the way they do only because of their roots in emerging markets. In the preceding sections, at least three contextual variables surfaced, beside country of origin, that have important implications for the internationalization strategy of firms: (1) *the global context for internationalization*, which affects the ease with which emerging market firms can internationalize; (2) the *stage of evolution of the firm as an MNE*; and (3) the *industry* in which it operates, e.g., natural resources, basic industries, etc. (see Figure 1).These variables, along with idiosyncratic firm factors, shape the internationalization strategy of EMNEs which, in turn, affects the speed at which they internationalize, the countries they target, and the modes of entry they use. If we pay attention only to an EMNE's country of origin, we are certain to overestimate its effect on EMNE behavior. For instance, if EMNEs are in the early stages of multinationalization and DMNEs are at the mature stage, that alone may explain some differences in their behaviors. After correcting for these effects, we may conclude that EMNEs are less

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different from DMNEs than we first thought—but still different, because country of origin also matters.

A third conclusion is that EMNEs may have strategic options that we have not seen with DMNEs. One example is that of the EMNE going abroad to bring back technologies and brands for exploitation in the home market. Another is the case of EMNEs whose internationalization is based on exploiting *differences* across countries rather than similarities; this includes companies that start out as contract manufacturers or supplier partners of developed country firms and then become MNEs in their own right. Yet another is the EMNE that globally consolidates sunset industries. In all these cases, EMNEs can be expected to invest in developed countries, including through M&A.

This leads to the fourth conclusion: that our models of the internationalization process seem particularly in need of refinement and extension to incorporate the case of EMNEs. Both the stages model and the product cycle hypothesis resulted from studying outward FDI by firms in rich countries in the 1960s and 1970s, and they are particularly wanting when applied to outward FDI from poor countries in the 2000s. They are fixated on market-seeking internationalization among countries with similar levels of development and have no room for arbitrage-based internationalization, which is a huge opportunity for companies from low-cost countries operating in a flatter and more open global economy.

Finally, the greatest payoff from studying EMNEs is not finding out if and how they differ from DMNEs, but the chance it offers to develop more comprehensive theories of the internationalization process. Since the birth of the IB and strategy fields, there has been no richer opportunity than now to study how firms *become* MNEs, because the drama is unfolding before our very eyes across the developing world.

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