

# 4. Outward investment from emerging markets: time for a paradigm shift?

*Suma Athreya*

## 4.1 Introduction

Almost all management scholars will readily agree that the isolation of context in the discussion of new phenomena is not water-tight but merely a theoretical device to focus more sharply on the subject of discussion. What happens when as management scholars we confront new phenomena? A common approach is to try to conform to existing theory with incremental improvements rather than improve the theory by making context explicit. Theories developed in advanced, Western economy contexts may be biased in the contextual elements they privilege and emphasise in subsequent attempts to advance theory. Context may need be brought from the background of theoretical discussion to the foreground of study in order to understand the rationale for strategy. Doing so also enables us to find broader theoretical frames that are able to accommodate multiple contexts.

This argument about confronting theory with new phenomena is an old one in the philosophy of science and dates back to the work of Kuhn (1962). Kuhn claimed that a careful study of the history of science reveals that development in any scientific field happens via a series of phases. In the first phase, a community of researchers who share a common intellectual framework – called a paradigm or a “disciplinary matrix” – engage in solving puzzles thrown up by discrepancies (anomalies) between what the paradigm predicts and what is revealed by observation or experiment. Most of the time, the anomalies – failures of the current paradigm to take into account observed phenomena – are resolved either by incremental changes to the paradigm or by uncovering observational or experimental error. As anomalies accumulate, the time

becomes ripe for a paradigmatic shift. The classic example is that until the theory of relativity was discovered by Einstein (which gave birth to the field of quantum mechanics), physicists only had Newtonian gravity to work with, even though physicists knew that it produced anomalous results.

This chapter is a Kuhnian analysis of the huge literature that has emerged on outward investment by emerging economies and the phenomenon of emerging multinational enterprises (EMNEs). I trace the development of theory to explain international investment by the EMNE. This theory has been marked by adherence to a canonical model of internationalisation that is drawn from the behaviour of Western firms in the post-war era. Although this adherence has been periodically challenged by new empirical analyses, internationalisation theory is also constantly adapting to the new facts. Yet the theoretical discussion has often left out/dismissed elements that are not considered as central/critical. Three contributory factors that are often overlooked in discussions of EMNE strategy are the role of improvement in the terms of trade and exports in enabling outward investment, the role of buoyant financial markets and the peculiar phenomenon of a parallel migration of high net worth individuals. I propose a broader framework based on real options theory that may present a better explanation of the unfolding reality of outward investment by both developed and emerging market multinationals.

## 4.2 Canonical models of internationalisation

The widely accepted model of firm internationalisation explains internationalisation as an outcome of firm-specific advantages (FSAs) and country-specific advantages (CSAs) in the home and host countries, following Collinson and Rugman (2011). CSAs are the advantages of a country which derive from its institutions (following Porter's diamond model, this could refer to the quality of suppliers, national institutions, natural resource endowments and competitive environment facing firms) while FSAs refer to the advantages of particular firms which may reside in their unique capabilities and resources (such as personnel, technology, and/or equipment). Combining those two dimensions in a matrix, we can predict the internationalisation behaviours exhibited by the firm. If the CSAs of the home country are dominant and FSAs rather weak, economic theories argue that comparative advantages of a country (or the location within an industrial cluster) will lead to exports – regardless of the specific characteristics of the company. If FSAs are strong and CSAs are weak, the focus of the international strategy is on exploiting the company's resources, without much influence from the location. In case FSAs and CSAs are both

strong, a firm has an incentive to operate across borders, and to coordinate its resources across borders and needs to combine the FSA of the company with the CSA of the host country (and, maybe, the CSA of the home country) in order to be successful (Rugman et al., 2011: 766–768). Thus, the combination of FSAs with CSAs in different locations is the true challenge of international management.

The CSA–FSA framework itself was a refinement of an earlier theoretical approach by Dunning (1988, 2001) – the so-called ownership-location-internalisation (OLI) theory – which explained the internationalisation activity of multinational enterprises (MNEs) as their attempt to extend their ownership advantages (e.g. proprietary access to a superior production technology or a valuable brand) to overseas markets by exploiting locational advantages (locating abroad to access low cost inputs or better serve local markets), and internalising the efficiency gains from economies of scale and scope by integrating the firm’s activities across borders. The CSA–FSA framework succeeded in synthesising the insights of the OLI with the more mainstream strategy literature on competitive advantage, pioneered by scholars like Michael Porter, which had emphasised the role of institutions and market structures as elements of the economic environment, which influence competitive strategies. The CSA dimension was intended thus to capture many of the elements of the economic environment which could influence competitive outcomes and thus provide a theory for explaining the location of investment activity.

The rationale that foreign direct investment (FDI) enables firms to exploit their existing firm-specific assets has been challenged on both theoretical and empirical grounds. On theoretical grounds, Caves (1996) pointed out that these arguments only apply to horizontal FDI. Although the rationale for vertical FDI is similar to that of vertical integration – securing stable supply, avoiding coordination problems and reducing transaction costs – this does not need ownership advantages in the form of proprietary assets. In another important paper, Fosfuri and Motta (1999) questioned the widespread argument that firms embarking on FDI must possess some specific advantages to offset the penalties of operating across national and cultural boundaries. Using a simple model they showed that firms might invest abroad to capture local advantages through geographical proximity of plant location, rather than to exploit existing ones. Due to the spatially bounded nature of spillovers (e.g. because of movement of labour), laggard firms might use foreign investments to acquire location-specific knowledge, whereas leading firms might prefer costly exports to avoid the dissipation of their advantages.

Empirical research has found that the relationship between ownership advantages and outward FDI is often weak (see, for instance, Belderbos and Sleuwaegen, 1996 in the context of Japanese firms). The Linkage, Leverage, and Learning model developed by Mathews (2006) aims to capture the idea that “latecomer firms” (in his case he was looking at South Korea, Taiwan, Singapore and Hong Kong) will use their overseas investments and global linkages to leverage their existing cost advantage and learn about new sources of competitive advantage. If so, internationalisation may contribute to the building of ownership advantages rather than merely being an outcome of existing advantages. Thus, confronted with a context that was not Western, both the leading theoretical approaches based on firm-specific advantages were found wanting.

These matters of inconsistency came to a head when there was a large outflow of investments from India and China and other emerging market multinationals from the late 1990s. Like Mathews (2006), Child and Rodrigues (2005) found that Chinese firms had internationalised partly to exploit competitive advantages, but also to address the competitive disadvantages incurred by operating in exclusively domestic markets. Others like Kumar (2008) studying Indian firms argued that internationalisation was a natural consequence of liberalisation in these two larger emerging countries where government policies of foreign exchange control had denied the use of outward investment as a strategy. What was notable about those early arguments was that ownership advantages in the standard terminology were found wanting in their explanatory power.<sup>1</sup>

One response to this overwhelming evidence from EMNE contexts was to argue that the way FSA had been conceptualised in the literature was unnecessarily narrow. Ramamurti and Singh (2009), but also Kumar and Chadha (2009) argued for a broadening of the definition of FSA and elaborated the different nature of FSAs enjoyed by EMNEs that derive from an “adverse environment” for business and the EMNE ability to adapt imported technology to develop products suited to the special needs of local customers. Examples include making products cheaper and more affordable, making products that were rugged and easy to maintain in harsher road conditions, the provision of after-sales service and lastly operational and technological efficiency in the presence of poor power supply and infrastructural impediments. Yet, in this very Kuhnian resolution of inconsistencies between theory and empirical evidence, context had forced itself on the discussion – largely in the form of institutional environments that affected firm behaviours and enabled the development of unique dynamic capabilities among the EMNEs.

### 4.3 Institutions as context and the role of CSA in EMNE internationalisation

Although emerging markets constitute a culturally and economically heterogeneous group of nations, their similarity rests on the distinctive and common features of poorly functioning institutional environments that hinder the growth of businesses. In the parlance of the CSA/FSA framework, they all suffer from some sort of deficit in their CSA, although this may not be uniform across sectors. Weak home country institutions which we may think of as a country-specific disadvantage (CSD) have a significant and often similar impact on emerging market firms' internationalisation strategies (Luo and Wang, 2012; Peng et al., 2008). Thus, the story of internationalisation from emerging markets has often been seen as a response to the push and pull of institutional factors (or CSD) faced by firms with non-standard FSA.

Luo and Wang (2012) identify and justify the existence of a systematic association between country-specific ownership advantages stemming from home market and domestic firms' overseas expansion. Specifically, they show that timing, location and scale of outward investment of Chinese firms are dependent on the competitive advantage they gain from the home market. Similarly, Wang et al. (2012) suggest that government-related ownership advantages shape firms' level, location, and type of overseas investment. Cuervo-Cazurra (2011) finds that many EMNEs first develop domestically the knowledge to manage complexity and differences in competitive conditions and institutional environments that subsequently facilitates foreign expansion and explains these firms' non-sequential internationalisation. Thus, the disadvantages experienced at home can become advantages when venturing abroad, as successful EMNE firms have learned to survive in "unfavourable" conditions. Inverting the traditional notions where the CSAs are largely seen as supporting FSA, the exciting finding in the case of EMNEs is that more successful firms develop hard to imitate FSAs, due to the deficits in CSA.

In contrast to the above studies, which have mainly looked at the pull of internationalisation strategies due to distinctive FSAs of EMNE firms, a large literature has also argued that institutional imperfections may push EMNE firms towards internationalisation to acquire supporting CSA in the host environment. As already noted, Mathews (2006, 2017) in the context of his study on the four dragons (South Korea, Taiwan, Singapore and Hong Kong) suggested that international expansion is strategic because of the advantages that late-comer firms can access in foreign markets. According to him, firms internationalise by acquiring strategic resources through linking in foreign markets,

learning to expand ownership advantages and leveraging their ownership advantages in combination with new resources. Concomitantly, such firms also embrace a learning mentality and adopt novel means of learning to ensure foreign market survival. In a similar vein, Luo and Tung (2007) and Yamakawa et al. (2008) have argued that emerging market firms use internationalisation as a “springboard” to overcome their latecomer disadvantages in the global arena and are not evolutionary but radical in their international expansion. These strategic resources include advanced technology, brand name, managerial expertise, and access to the customer base in foreign markets. Boisot and Meyer (2008) and Cuervo-Cazurra and Genc (2008) add that emerging market firms may leverage “institutional arbitrage”, which indicates that EMNEs search for more efficient institutions outside their home markets.

Thus, the pull and push arguments for internationalisation stemming from adverse institutional contexts suggest internationalisation may be used both to exploit and augment the distinctive FSA of EMNEs, which may also try to overcome institutional disadvantages or CSA deficits at home by exploiting CSA in the host country. This investigation of the impact of CSD on firm internationalisation strategy should be seen as another important contribution to the literature on EMNEs on the canonical models of FSA/CSA based theories.

#### **4.4 Omitted factors in theoretical explanations of EMNE internationalisation**

While it is undeniable that country-specific institutions, such as the rule of law, financial market development and protection of property, are important contextual factors that explain EMNE internationalisation, these are not the only aspects of context that matter. The economic circumstances of the late 1990s also influenced EMNE internationalisation because changes in the policy and global environment made obtaining finance for investment much easier than in the past. Growing exports at better terms of trade, the globalisation of finance markets and the accumulation of individual wealth were important antecedents to EMNE outward investment strategies. Using an analogy from statistical methods, I argue that omitting these contextual factors may have overstated the contribution of the CSA and FSA factors to internationalisation.

##### **4.4.1 Exports, terms of trade and outward FDI from EMNEs**

At the macroeconomic level, a factor that contributes to a nation’s ability to make outward investments is its export performance. Mirza and Miroux

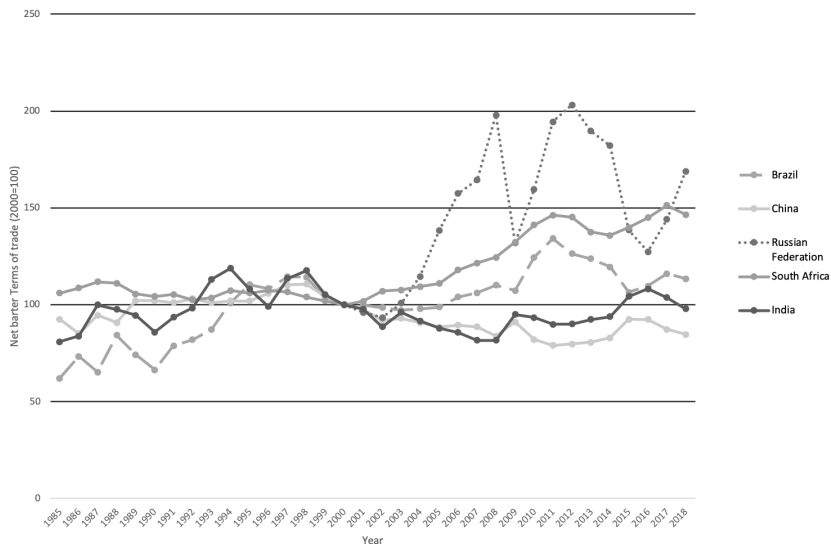
(2007) note that almost all the emerging market economies that sent investments abroad in the 1980s (such as Argentina, Brazil and India) had also seen an improvement in export performance and terms of trade vis-à-vis the world economy. This was also true of many emerging markets in the late 1990s, but especially for the BRIC countries (Brazil, Russia, India and China).<sup>2</sup> The accumulation of export surpluses in the current account must lead to exports of capital and so it was to be expected that all these economies would end up with investments abroad.

At the microeconomic level, there is much debate among scholars about the exact relationship between exports and outward FDI. Standard models like that of Johanson and Valhne (1977) see the internationalisation process of the firm as a continuum, starting from the low commitment stage of exports and licensing and moving to the greater commitment of resources implicit in setting up foreign subsidiaries as knowledge about markets, production and regulation in host countries improves. In this reasoning, FDI and home nation exports are substitutes. In vertically integrated enterprises such as steel mills or metal producers, the home nation operations of a multinational firm can be vertically linked with host nation operations, such that an increase in the activity in the latter generates increased demand for intermediate products, including capital goods, from the former. Some would argue that this might characterise Chinese investments in Africa (Athreye and Kapur, 2009). Furthermore, marketing and distribution capabilities created by FDI might enable the home nation operations to export final goods and services to customers that would not be reached in the absence of FDI. To the extent that either of these happens, home country FDI and exports will be complements.

The relation between outward FDI and terms of trade is equally important but understudied in the context of EMNE internationalisation. Chen (2012) estimates that between 2000 and 2010, the BRIC countries together more than doubled their share of world trade and China accounted for over two-thirds of that growth. In 2010, the BRICs accounted for over 17 per cent of the world total exports and almost 14 per cent of the world total imports. Chen (2012) also shows that the majority of the BRICs' trade was with high income economies (HIEs) – HIEs' share in the BRICs' total exports declined from 72 per cent in 2000 to 64 per cent in 2010 while the share in total imports declined from 62 per cent in 2000 to 54 per cent in 2010, respectively. This was compensated by the expansion of trade between the BRICs and low and middle-income economies (LMIEs) during the period. In 2010, over 30 per cent of the BRICs' total exports went to LMIE markets; while one-third of its total imports were sourced from LMIEs. These increases in export volumes also went hand in hand with improving terms of trade. Using World Bank data, Figure 4.1 shows

that Brazil, India and China saw an improvement of terms of trade from 1990 to 2000 while Russia and South Africa saw an improvement thereafter (from 2000 to 2008).

Chen (2012) also notes that the four BRIC governments are net foreign (currency) creditors. They accounted for almost 40 per cent of the world's total foreign currency reserves by 2010 (*The World Factbook* (CIA, 2011) as cited in Chen, 2012: 225). Although China was the dominant contributor, Russia, India, and Brazil also accumulated substantial volumes of reserves. With China's surplus increasing sharply, the BRICs' combined current account surplus exceeded \$280 billion in 2010 (IMF, 2011). Macroeconomic theory generally predicts that such surpluses on account of trade would fuel capital outflows both in the short and long term.



Source: World Bank data: <https://databank.worldbank.org/reports.aspx?source=2&series=TT.PRI.MRCH.XD.WD>.

Figure 4.1 Net barter terms of trade, BRICS economies (2000=100)

The combination of expanding exports and rising terms of trade gave several firms in emerging markets large cash balances just as the hyper-globalised world of the 1990s was emerging. What we understand less is how firms used those increased earnings. Cespedes et al. (2020) studying the US retail sector, found that following windfalls, small business owners favour internal and



external growth, and for some entrepreneurs, the existing business seems to be a gateway to other ventures. Work that is more interdisciplinary, perhaps by business history scholars, can help to fully understand the potential investment responses to such a windfall of unexpected profits. It seems reasonable to assume, however, that at least some of those profits from exporting may have been channelled into outward investments in new markets that represented future growth opportunities. Fortuitously, and as we discuss below, this branching out also coincided with a period when global financial markets were more open about the possibility of lending to emerging market firms.

#### 4.4.2 International financial markets and credit availability

It is well known that the financial systems in China and other emerging economies are underdeveloped (Buckley et al., 2007) and so failed to deliver the two important functions of any financial system, namely, the availability of a large volume of credit finance and delivery of risk-bearing investible funds. The availability of finance depends upon the presence of lenders and borrowers but the ability to spread risks depends on how deep the financial market is (thickness of buyers and sellers) and systems of monitoring that can evaluate and price risk.

The four BRIC countries are different in their experience of the financial disadvantage that a weak institutional framework creates. China and Russia have a shorter history of market-based financial transactions compared to India and Brazil. Thus, in China and Russia, the state owns most of the banks and disburses credit according to government policy and a domestic stock market is still emerging. India and Brazil – both mixed economies – may have somewhat more developed financial institutions, boasting a larger number of private sector banks and a shallow but functioning stock market. Studies on Brazil suggest the government retains a dominant control over the banking system (Ness, 2000). Financial markets in India are better developed but here too public sector lending is large and financial lending is also sensitive to the riskiness of investments, which in turn is reflected a higher cost of capital for investments perceived to be risky (Das and Banik, 2015). This means credit is not available to a whole class of borrowers perceived as risky (small firms, young firms) and also to projects perceived as risky (technological investments and foreign investments).

That financial constraints mark EMNE internationalisation is well recognised. Buckley et al. (2007) place considerable emphasis on financial market imperfections as a significant deficit in the CSA faced by several emerging market firms (including China which is the country of their focus) but argue that such

imperfections mean access to finance can confer special ownership advantages. In China and to a lesser degree in Russia, such privileged access to state resources confers special ownership advantages to state-owned enterprises which enable successful internationalisation. Other scholars like Khanna and Yafeh (2005) have argued that in many emerging markets such financial market disadvantages are overcome by organisational forms such as business groups who operate internal markets of finance for group companies.

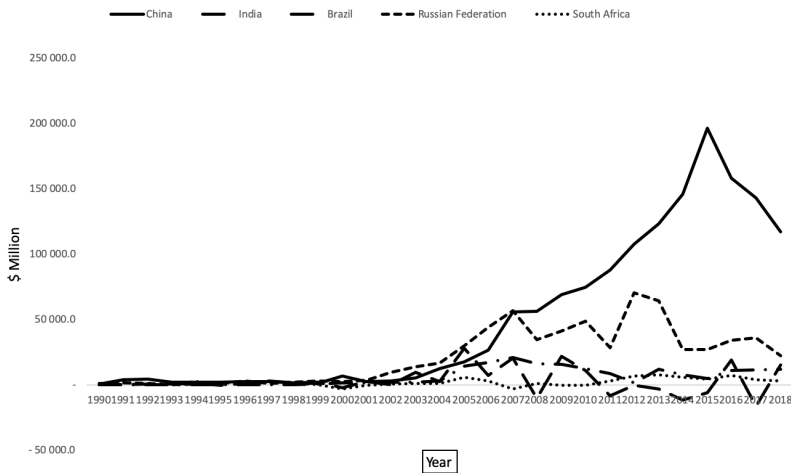
The period from 2000 to 2008, when many EMNE outward investments were first conceived and executed, was also an era of globalised, buoyant financial markets. In an era of globalised markets and finance, adverse financial institutions at home were not a constraint to outward investment as EMNEs were able to raise money for foreign investment overseas when they could not find it domestically. Nayyar (2008) notes that international capital markets were an independent and important source of financing international investment for many EMNEs and were typically not included in official national figures for outward FDI. Kumar and Chadha (2009) and Saeed and Athreye (2014) find that liberalisation of economic policy had the effect of mitigating internal financial constraints on domestic and foreign investment for Chinese and Indian firms.

After the financial crisis of 2008, world financial markets became more cautious about lending and demand in overseas markets suddenly became weak, affecting exports. Figure 4.2 shows that the outward investment paths of BRICS firms, which had looked similar, began to diverge sharply after the financial crisis. In particular only Chinese firms have been able to sustain the growth of outward investments. If only FSAs were involved in outward investments, such a shift in trend for Brazil, India, Russia and South Africa should not have taken place. This divergence of outward FDI pattern between China and the other BRIC economies, in turn raises some interesting questions: Could it be that the whole pattern of outward FDI from emerging markets was driven by buoyant global financial markets? Does the sustained availability of finance constitute a boundary condition, where we can see the development of FSA? We do not know the answers to these questions but I pose them here because omitting this factor could overstate the role of FSA/CSA in the traditional paradigm.

#### 4.4.3 Capital flight and its impact on outward investments

A third economic circumstance not considered in the literature is the effect of wealth accumulated in many emerging markets, including through corruption by political elites. The desire to protect this wealth for progeny (and from tax and political risk) has been a major factor fuelling the rise in offshore tax

havens and secret overseas accounts. A lively literature in political science has examined the effects of tax on millionaire migration and concluded that such migration is less sensitive to tax rates than commonly thought (see Young and Varner, 2011; Young et al., 2016), but the field of EMNE internationalisation is oblivious to these trends.



Source: UNCTAD, FDI/MNE database: <https://www.unctad.org/fdistatistics>.

Figure 4.2 Outward FDI from BRICS economies (1990–2019)

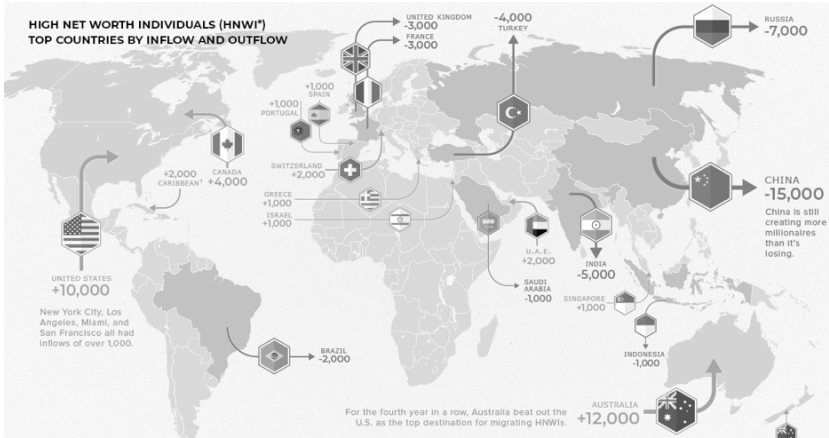
Since the mid-1980s, wealth migration has been a prominent feature of Russia and other transition economies. Brada et al. (2013) estimate that such capital flight<sup>3</sup> (as it is sometimes referred to) is almost always a result of the investor thinking that the risk-return in the host economy is more attractive than in the home economy and fuelled by financial liberalisation. This capital flight is very closely related to the development of domestic financial markets. When financial markets are poorly developed they do not have a wide variety of savings instruments to soak up domestic savings, and investible funds may seek foreign outlets/savings instruments. Brada et al. (2013) outline that the most frequent ways in which private money is moved abroad is through a sort of transfer pricing and mis-invoicing and “fictitious” outward investment. This finding raises the prospect that, depending upon the source of data, some of the EMNE investment may also be overstated/understated. Outward invest-

ment data from the home country will understate and inward investment data from the host country will overstate the volume of foreign investment.

Although in the past estimating such capital flight has been tricky, in the last four years, the Global Wealth Migration Review (GWMR) has provided a more direct measure by tracking millionaire migration (defined as the movement of high net worth persons who own assets in excess of \$1 million). GWMR (2019)<sup>4</sup> estimates that 30 per cent of this wealth migration or capital flight happens through investor visas, where foreign nationals bring in stipulated amounts of investment in exchange for citizenship.

The truly astonishing fact about millionaire migration and the associated capital flight of recent years is clear from Figure 4.3. The figure shows that the BRIC countries and Turkey are losing more high net worth individuals, defined as persons with assets greater than \$1 million, than other countries and the developed world is the chief beneficiary gaining them. The relationship between this migration and the uphill flow of investment from emerging markets to developed countries needs more attention, especially in countries where outward investment may be politically directed. Hitherto, the argument has been that EMNEs go in search of strategic assets to developed country markets. However, the data on millionaire migration may reveal the role of corruption legacies in determining the direction of outward FDI flows. Put differently, ignoring the context of wealth migration to avoid taxes, find new avenues of investment or simply to consume better quality collective goods like public health and education, might also lead one to overstate the role of CSAs in explaining the direction of outward investment.

Another reason could be that human capital and financial capital may play complementary roles in a range of service industries. Whatever the relationship between EMNE investment and wealth migration, progress in this area of study needs greater engagement with political science literature on elites and perhaps also literature in sociology on patterns of diaspora development and skilled and entrepreneurial migration. Such interdisciplinarity has been largely absent in the study of EMNE investments. Instead by looking at the phenomenon in silos, we may have overestimated the influence of FSA/CSA and ignored the links of outward foreign capital with the rewards to human capital in emerging markets.



Source: <https://www.visualcapitalist.com/millionaire-migrants-countries-rich-people-flocking/>.

Figure 4.3 Millionaire migration

#### 4.5 Time for a paradigm shift? Real options theory as a better lens for understanding EMNE behaviours

The foregoing section has shown that contemporary EMNEs and political elites in emerging markets have enjoyed a range of exogenously created opportunities brought about by exceptionally buoyant global financial markets and export market successes that have created favourable country of origin effects. Yet the effect of these on firm investment behaviours cannot really be accommodated fully in the canonical models currently in use. Being relative newcomers to the international investment, many EMNE outward investments were initially exploratory in nature, trying to discover those markets and locations where they could leverage their limited advantages – a different starting point from Western MNEs that had already established firm advantage they could leverage from the outset. Additionally, EMNE outward investments faced uncertainty on various counts: institutional disruptions when they entered new countries, fluctuations in currency value and unexpected changes in demand. Their outward investment activity, undertaken in response to sudden windfalls (such as an export boom or significant increase in private earnings) or access to global finance, are better analysed using a framework that incorporates potential uncertainty and rewards to investment activity. The exploratory nature of investments may also mean flexibility across a range of responses to uncertainty – such as switching the location of resources, divest-

ment of investment and expanding investment – may be very important for the EMNE to take into account. Real options thinking which is popular in the analysis of financial asset portfolios may be a very useful framework for such analysis.

Bowman and Hurry (1993) define “real options” as investments that are discretionary in that they offer firms the right, but not the obligation, to take future action. Such options are particularly valuable in times of uncertainty as they provide flexibility to firm investments. In the field of international business, Kogut and Kulatilaka (1994) suggest that foreign investments can effectively serve as a platform for future expansion, creating real growth options that the multinational firm otherwise would not be able to obtain. If the opportunities for expansion materialise, and uncertainty is resolved, the foreign investment serves as a stepping-stone for further expansion of operations in the target country. Such a perspective is very consistent with the Johanson/Vahlne argument of gradually increasing commitments in a staged process of internationalisation.

Defining a real option, however, requires a consideration of the types of uncertainty and growth options associated with particular investments. Without uncertainty, there would be no option value that is different from the present value of an investment. The more detailed the uncertainty and growth profiles can be, the better is the description of the real options (for action) that the EMNE faces. Thus, a key requirement for using the real options approach is to identify the sources of uncertainty, which in turn give rise to strategies that enable a firm to keep (investment) options open: either by increasing investment in some activity lines or locations, switching investment across activity line/locations, or withdrawing from activity lines/locations.

While discussing a real options framework, a distinction is often made between exogenous and endogenous sources of uncertainty. Chi et al. (2019: 541) provide the clearest definition of this distinction using the language of stochastic variables with mean ( $\mu$ ) and standard deviation ( $\sigma$ ).

To make the distinction between exogenous and endogenous uncertainty clearer, we need to determine whether the action under consideration (e.g. market entry) would influence the parameters (i.e.,  $\mu$  and  $\sigma$ ) of the distribution of the stochastic state variable (e.g. cost, demand, profit or project value).

Exogenous uncertainty is present when there are parameters that affect a firm’s revenue stream, which the investing firms’ action cannot influence. Buckley et al. (2020) consider as exogenous risks all those that influence MNEs and

other actors in a uniform way. Prior studies on advanced country EMNEs have confirmed that multinational firms do adjust operations of affiliates in response to changes in relative cost and market conditions. Rangan (1998) finds that changes in exchange rate movements lead to shifts in manufacturing and intra-firm imports of US foreign subsidiaries. Fisch and Zschoche (2012) observe uncertain labour costs as an antecedent of German firms' foreign divestment. Song et al. (2014) find that labour cost differentials are a reason for intra-firm production shifts within Korean multinational networks. The impact of disasters (including war) can also be considered an exogenous uncertainty that impacts upon MNEs' strategic commitments (Dai et al., 2017; Oetzel and Oh, 2014). Exogenous uncertainty is often location-specific and closely related to CSA in the host country.

The important property shared by all sources of exogenous uncertainty is that the MNE can passively, through experience, find more information and act on that basis to lower the impact of that uncertainty on the state variable of interest, profits, market share, etc. The ability to wait is crucial to the resolution of exogenous uncertainty and having deep pockets may help with the waiting. In the context of EMNEs, the close relations between the state and EMNEs (as in the case of state-owned enterprises), may mean that this ability to wait is greatly enhanced. Certainly, Chinese and Russian EMNEs seem to be privileged in this regard.

Endogenous uncertainty on the other hand relates to uncertainty that is unequal between firms and which firms can influence through their own actions. Endogenous uncertainty is strongly related to the strength of a firm's competitive position and its FSA. For example, an MNE making a small initial commitment through a joint venture in order to enter a new market is faced with endogenous risk. Although the market seems attractive, it may take more active learning in the form of selling in the market to fully understand the costs and benefits of the investment as well as the attributes of the product that are attractive (relative to competitor offerings) in the foreign market. A small initial commitment (with a local partner) secures a future growth option. Chi et al. (2019) also argue that when there is the potential to invest in stages, i.e. starting small and growing the investment, endogenous uncertainty can give rise to powerful learning effects. Such effects are noted in Mathews' Linkage, Leverage, and Learning model based on the internationalisation of the four dragons or Luo's Springboarding model based on the experience of more recent EMNEs from the BRICS countries.

EMNE firms being new to the international market, probably face higher degrees of endogenous uncertainty because of not knowing where exactly their

competitive advantages lie and their weaker FSA. (In contrast, one could argue that MNEs in advanced economies were more sensitive to exogenous uncertainties as they had a clearer idea of their own markets and competencies.) EMNEs were therefore more likely to hedge their (investment) bets by making investments in both developed and developing countries. In turn, this meant they faced different levels of country risk in their portfolio of international investments.

In response to endogenous and exogenous uncertainty, EMNE firms could deploy a number of different strategies, e.g. expanding investments, delaying investments, switching investments or divesting investments. In the case of each action, other factors would come into play. Thus, expanding investments were more likely to be employed when there was a positive shock in the form of new growth opportunity. However, foreign exchange uncertainty or labour costs uncertainty (due to strong unions for example) may give rise to switching and divestment behaviours. Anecdotal evidence exists of the difficulties of dealing with local labour unions by Chinese firms (Zhu, 2015). One problem in the EMNE literature is also that the various actions of the EMNE beyond initial (entry) or expanding investment are not that well studied – more careful data on the survival and divestment of EMNE investments is needed to expand the menu of actions.

Do political and country risk constitute exogenous or endogenous uncertainty in the location decisions of MNEs? Early studies often assumed political risk to be exogenous to MNEs, as MNEs were thought to respond passively to the environmental characteristics of the host country (Buckley et al., 2007; Globerman and Shapiro, 2003; Loree and Guisinger, 1995). More recent work in Buckley et al. (2020) argues that country and political risk is an endogenous uncertainty as firms can lobby governments and mitigate adverse impacts. A similar argument can be made for institutional difference and uncertainty.

The real options framework with its emphasis on uncertainty and flexibility is capable of nesting within it the two major approaches discussed in sections 4.2 and 4.3 (these are the CSA-FSA and springboarding behaviour explanations of the phenomenon of internationalisation respectively). It enables the incorporation of several other contextual factors largely ignored in the discussion of EMNE internationalisation. However, this approach also requires a clearer delineation of context (type of uncertainty and advantage) and a range of actions (entry, expanding, switching and divestment of investments).



## 4.6 Why does it matter?

One might reasonably ask, since all theory is in some way a simplification of reality, can one really incorporate all contextual factors and finally what does paradigm shift achieve? This question recalls the philosophical arguments posed by Borges (1946) and Eco (1994) on the impossibility of drawing a map that accounts for every aspect of reality. Equally dangerous is the tendency to regard the map or conceptual model as the territory/reality. This was explained by Baudrillard (1981/1994: 1) in the following way:

Today abstraction is no longer that of the map, the double, the mirror, or the concept. Simulation is no longer that of a territory, a referential being, or a substance. It is the generation by models of a real without origin or reality: a hyperreal. The territory no longer precedes the map, nor does it survive it. It is nevertheless the map that precedes the territory – precession of simulacra – that engenders the territory, and if one must return to the fable, today it is the territory whose shreds slowly rot across the extent of the map.

It is of course possible that adherents of the first school will not be persuaded by the fears of the second. Disciplines like physics and economics have accommodated both sorts of thinkers by distinguishing empirical and theoretical contributions as a division of labour within the discipline. This has been an efficient sorting and the pace of discovery in both sub-disciplines has increased over time but has come at a cost because the dialogue between the two schools (theory and empirics) is minimal.

In the international business space too one can see the beginnings of such a bifurcation with the two leading journals, namely, *Journal of International Business Studies* (JIBS) and *Journal of World Business* (JWB). While JIBS prides itself on theoretical contributions and has several to its credit, JWB has established a strong reputation for study of phenomena – grounded in theory but still looking to articulate what is new in the empirical reality. As in the case of other disciplines, such bifurcation can come at the cost of a dialogue between context and theory and paradigm shift may potentially lead to a third way that unifies theory and empirics.

The real options framework is proposed as a less restrictive theoretical framework that is capable of incorporating the realities of EMNE expansion far better than the FSA/CSA framework. However, in order to develop the framework in a realistic way we need to commit ourselves to a research program that builds the theoretical and empirical foundations of a new paradigm. Theoretically, the new paradigm should reflect better understanding of

both the options available for investment and the uncertainties faced by the MNE and EMNE actors involved. This is consistent with bringing the context back in and making it the foreground of any discussion of international strategy. Empirically, there should be a commitment to study a wider range of actions – beyond the initial foray into a new market. Expansion, switching of investment and divestment should all be observed with as much care as the initial entry. Further understanding the uncertainties, risks and rewards of international investment needs much closer attention to contextual details and to understand the debates in neighbouring disciplines like political science and business history. Interdisciplinary study of context should ultimately shape the direction of theoretical evolution that helps us generalise from new realities.

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## Notes

1. See also the debate in the *Asia Pacific Journal of Management* in 2006 (Dunning, 2006; Mathews, 2006; Narula, 2006), where Mathews emphasised that he saw his LLL as a strategic framework which far from displacing microeconomic reasoning of OLI, was a way of complementing the timeless insights of OLI with the strategic necessities of latecomer firms that were seeking to become players in the globalised economy.
2. Some authors include South Africa in this group and the acronym used then is BRICS.
3. Capital flight can be defined as unregistered private capital flows which may be for legal (economically profitable activities) or for illegal activity (think money laundering).
4. The report is produced by the AfrAsia Bank and available online from <https://www.afrasiabank.com/en/about/newsroom/global-wealth-migration-review-2019>.

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