

THE COMPETITIVE ADVANTAGES AND INTERNATIONALIZATION OF EMERGING ECONOMY BUSINESS GROUPS

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Abstract: The existing literature on the competitiveness of emerging economy firms does not fully distinguish the different types of firm-specific advantages that influence the firm's internationalization decisions. This paper addresses this by focusing on emerging economy business group firms and offers a novel theoretical framework on their specific advantages, derived from their organizational structure. It applies the concept of recombination capabilities and proposes that the organizational structure and group internal market of business groups are the key to understanding the dynamics of their competitiveness and internationalization. Also, the paper suggests that business group advantages have implications on the affiliate level advantages and the group multinationality over time.

Key words: emerging economy firms, business groups, business group advantages, affiliate level advantages, internationalization

Introduction

The literature on the competitive advantages and internationalization of emerging economy firms is complex. This is because the analyses are often broad and based on the different growth stages of these firms (Luo and Tung, 2007). Also, emerging economy firms are frequently compared to advanced economy firms which contributes to the misconceptions on the actual nature of their competitive advantages (Contractor, 2013; Cuervo-Cazurra, 2012; Ramamurti and Singh, 2009). Therefore, there are still some disagreements as to what exactly are the competitive advantages of emerging economy firms. This paper addresses this issue by focusing on one type of emerging economy firms, that is the business group. The main objective is to present a theoretical framework on competitive advantages that is specific to business groups, and the potential influence of these advantages on their international expansion. A business group (hereafter abbreviated as BG or BGs) is defined here as a hierarchy of independent firms, conceived to collaborate in different markets, domestic or international, under a common administrative control; the affiliate firms are linked by various social and economic exchanges, interpersonal trust, and mutual adjustment. BGs are common in emerging economies but the nature of their competitive advantage is still understudied (Colpan et al., 2010). One of the reasons is that the emerging economy literature does not fully differentiate the BG from any other type of emerging economy firms (Ramamurti and Singh, 2009). Therefore, there is no

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distinction on the types of firms and kinds of competitive advantages in the analyses. This paper contends that the emerging economy firms should be discriminated by types, particularly their organizational structure, as different types of organizational structures result to different kinds of competitive advantages and internationalization patterns. Thus, the paper attempts to dichotomize the competitive advantages of emerging economy firms as well as avoiding generalizations. This paper constructs the above arguments by reviewing the theories on the competitive advantages of multinational firms and the emerging economy firms. This is followed by an original conceptualization of the competitive advantages of BGs and the proposed influence of such advantages on their internationalization.

Literature on the Competitive Advantages of Multinational Enterprises

The study of the competitive advantage of multinational enterprise (MNE) occupies a major part in the international business literature. The main assumption is that the resources and capabilities of the firm determine its internationalization strategy and structure. The firms that own and control superior resources and capabilities across national borders are likely to disadvantage other firms (Hymer, 1976). These multinational firms achieve such superiority by avoiding structural and natural market imperfections across different markets. The key to this feat is rationalized by the act of organizing an efficient internal market within the firm rather than the open market; an explanation based on internalization theory (Buckley and Casson, 1976; Rugman, 1981). At some point the knowledge that is generated by the firm is very specific to its nature, far superior and priceless compared to the conditions and potentials of the market. Thus, to maximize and control the private returns of that knowledge, the firm has to preserve it in every level within its organizational structure. As a result, the utilization, protection and control of such superior knowledge determine the boundary as well as the competitive advantage of the multinational firm (Buckley and Casson, 1976). It follows that operating in different markets across borders confers them with heterogeneous set of advantages which are developed, transferred, and exploited within its network of affiliates from different locations. This differentiates multinationals from pure domestic or single-location firms. To further analyze the competitive advantages of MNEs, it is useful to employ the FSA/CSA matrix to give an emphasis on the characteristics of each type of advantage that any MNE would possess. Nonetheless, as a general principle, the FSA/CSA matrix offers an analysis of both the advantages at the same time (Rugman, 1981).

MNEs Driven by Knowledge-Based Firm-Specific Advantages

The Firm-Specific Advantages (FSAs) are defined as unique capabilities proprietary to the firm. They may be built on products or process technology, marketing or distributional skills (Rugman, 1981). In the literature, FSAs are

assumed to exist before a firm embarks to internationalization. Dunning (1980) captures this through his eclectic paradigm or the OLI framework which identifies the firm's ownership advantages (O) or FSAs, locational advantages (L) and internalization advantages (I). He argues that these three advantages and their combinations are able to explain the investment patterns of firms or foreign direct investment (FDI) in international markets. The eclectic paradigm suggests that firms develop their ownership advantages at home and then transfer them to other countries, where there are also complementary resources, through FDI. This will eventually lead to their multinationality. On the other hand, other theories in international business such as the Uppsala model, suggests that the internationalization process takes time due to investment risk and commitment coupled with organizational learning (Johanson and Vahlne, 1977). Those that can learn faster and offset their liability of foreignness, by possession of superior advantages, are likely to succeed in their internationalization attempts.

MNEs Driven by Country-Specific Advantages

The firms from highly advanced countries usually have a very strong Country-Specific Advantages (CSAs). The CSAs are positive country factors such as labor, natural resources and government policies which can be employed by firms when expanding abroad. On one hand, the newly liberalized countries, especially China and India, deliberately heightened the speed of internationalization of their firms using different motives or strategies. The case of Chinese emerging multinationals is a classic example of home country driven internationalization facilitated by interventionist government policies. Beginning the 1980s, the Chinese government pursued economic reform by transforming and restructuring state enterprises into large enterprises. This accelerated internationalization provides Chinese firms with an opportunity to secure strategic assets and build capabilities, and turn their "latecomer" status into a source of competitive advantage (Luo and Tung, 2007). In other cases, some firms relied heavily on CSAs such as endowments of capital from their government to ease their mode of entry such as acquisition or greenfield (Ramamurti and Singh, 2009). Here we see the influence and ownership advantages of countries and institutions in influencing the organizational dynamics and internationalization decisions of firms.

The Competitive Advantages of Emerging Economy Multinationals

Emerging economy firms follow a unique pattern of creating their competitive advantages (Ramamurti and Singh, 2009). In recent years, there has been a substantial increase of Outward Foreign Direct Investment (OFDI) made by large enterprises coming from the developing and emerging economies (UNCTAD, 2012). They are conventionally called *emerging economy multinationals* (hereafter abbreviated as EMNEs). One of the issues related to the international growth

of EMNEs is the explanation of their competitive advantages, compared to those of the traditional advanced economy MNEs (Cuervo-Cazurra, 2012). Some researchers suggest that the different institutional contexts of their home economies explain the nature of their competitive advantages (Khanna and Palepu, 2000; Ramamurti and Singh, 2009). Hence, different economies create different conditions for the interaction of institutions, market imperfections and the development and exploitation of advantages. In weaker economies, where economic inefficiencies and scarcity of knowledge prevail, firms devise a particular pattern of building advantages. Firms may not be able to, at some point, acquire or own any valuable knowledge at all. The resulting stand-alone firm advantages are not as strong compared to firms in the tacit knowledge creating advanced economies (Verbeke, 2009). The previous studies suggest that firms in these economies are only able to advance their knowledge or competencies through contractual access through alliances and joint ventures with the more advanced multinationals from developed economies (Amsden and Hikino, 1994). Another response is through cooperation that is forming networks or BGs. Through these approaches, emerging economy firms develop some organization or transaction-based advantages that are not necessarily a kind of country-specific advantages or knowledge-based firm-specific advantages. These organization and transaction-based advantages are specific to emerging economies which arise from dealing with different levels of institutional voids and market imperfections that are prevalent in developing and emerging economies (Khanna and Palepu, 2000).

Theoretical Framework and Propositions

One type of firms in emerging economies that develop the kind of organization and transaction-based advantages is the BG. However, the existing literature is sparse in explaining these contextual advantages of BGs. Thus far, the perspectives in explaining the antecedents of the competitive advantages of BGs are identified broadly as exogenous and endogenous force explanations (Colpan et al., 2010). The exogenous force explanation includes the perspectives which look at a number of conditions which create supply and demand for the advantages of BGs to emerge. It can come from government policies, institutional voids, cultural embeddedness and asymmetric foreign trade and investments. On the other hand, the endogenous force explanation focuses on how BGs, as economic organizations organize their resources and capabilities from within the boundaries of the group. This paper adheres to the endogenous rather than the exogenous explanation of the advantages of BGs. The reason is that exogenous explanations are types of environmental or institutional conditions which only serve as inputs to the development of the advantages of BGs and not the source of advantages themselves. Another is that the exogenous explanations may not predict the persistence and strengthening of BGs, if and when the institutional voids or constraints disappear, and when BGs are able to operate in multiple economies, that is, as multinationals under varying institutional conditions. The true

advantages of BGs do not lie on these conditions but on their innovative response to such conditions, that is internalization of market imperfections and endogenous capability building among the affiliates (Penrose, 1959; Mahmood et al., 2011). Therefore, this paper contends that the competitive advantage and persistence of BGs, in domestic and international markets, depends on the dynamics and functioning of their group internal market (Gonenc et al., 2007).

The Competitive Advantages of BGs

Although inconclusive, empirical evidence suggests that firms belonging to BGs, mostly in a domestic setting, perform better than non-business groups or stand-alone firms in these economies (Carney et al., 2011). Indeed, some of the most successful emerging economy firms are BG affiliated firms (UNCTAD, 2012). The competitive advantages of BG affiliated firms in emerging markets arise from the interaction of, and response to, specific country characteristics, imperfections in capital, labor and product markets, and the recombination capabilities of the affiliate firms. These advantages are supported by the accumulated knowledge that has been captured, owned and controlled by the BG over time. This paper calls these advantages the *business group advantages* (hereafter abbreviated as BGAs) as they accrue exclusively to BG affiliated firms. The BGAs are internalized and found within the BG structure and stored at the group level. Since a BG is composed of independent affiliate firms, the BGAs, in theory, can be found within each affiliate firm. From the literature, this paper synthesized the three generic components to describe the basic elements of BGAs (see Fig. 1).

These advantages are: (1) reduced *transactions costs* through the group internal capital, labor, internal buying and selling and market information search; (2) transferable *group managerial skills and experience* in product and geographical diversification, contacts and intermediation capabilities, and state relations; and (3) *economies of scale and scope* such as allocation and co-development of resources in the area of R&D/technology and marketing and distribution, group brand and reputation. The resulting structure of BGAs can be found and distributed among the affiliates in the BG. The BGAs on transaction costs clearly explain the incentives of reducing the risks and costs for searching or developing information and advantages in the external market (Leff, 1978). The BG structure provides an array of internal resources which an affiliate can exploit. For example, internal group capital is a very good source of capitalization for affiliates in times of investments, including foreign investments, and expansion (Gonenc et al., 2007). This explains their capability to seize multiple portfolios, and their affiliates to expand businesses not only in domestic but also in international markets. Another is the internal labor that assures quality and fit of people within the whole organization. The BGs in emerging markets operate training schools for grooming pools of employees within the group who will then be dispatched among the affiliates.

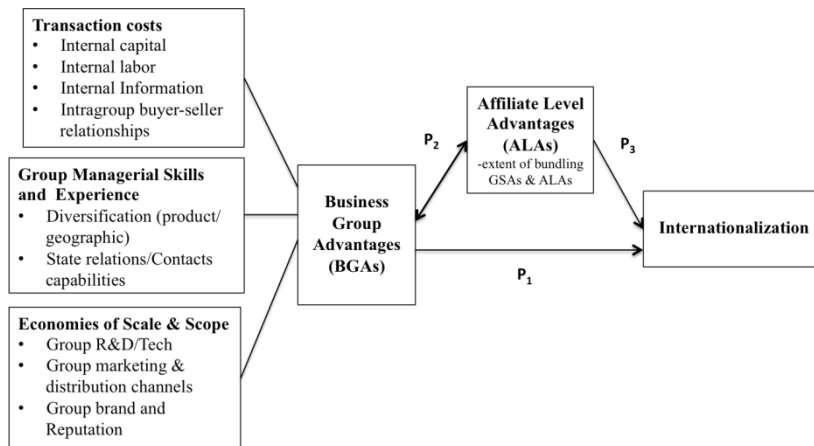


Figure 1. The relationship of BGAs and ALAs in influencing BG affiliates' internationalization

Lastly, a steady supply of inputs and intermediate products is a crucial advantage of BG affiliates. In times of scarce supply and low demand, affiliate firms can tap an intragroup buying and selling linkages.

On the other hand, the BGA on group managerial skills and experience provides a combination of context specific and transferable skills among BG affiliates. Amsden and Hikino (1994) argue that the repeated industry-entry pattern of business groups was realized because of their “contact capabilities” with the state and foreign multinationals, followed by “project execution capabilities”. These capabilities are generic to business groups and not industry-specific. They are difficult to trade because they are embodied in the organization’s owners, managers, and routines. In addition, BG experience in management of product and geographic diversification directly aid other affiliates in other potential product areas and locations.

Lastly, generic advantages of multi-unit organizations or conglomerates, such as BG, are the economies of scale and scope. The co-development of resources by BG affiliates in the area such as in R&D and technology, marketing and distribution provide leverage to all the affiliates in the group. Finally, an important and unique BGA is group reputation. The BG affiliates enjoy the ease of winning contracts or projects only because of their membership in a reputable BG which may have a very long successful history of operations and transactional relationships that create a positive halo effect to all the affiliates in the group.

Proposition 1: The business group advantages influence the internationalization of business group affiliates

The Affiliate Level Advantages

The concept of BGA explains the kinds of advantages at the group level, but it does not explain all the potential advantages that can be found at the individual affiliate level. This paper argues that what individual BG affiliates have are both a subset of the BGAs and affiliate-level advantages (hereafter abbreviated as ALAs). By building on BGAs, BG affiliate firms can develop specific advantages independently. These advantages are unique resources, capabilities and strengths specific to an affiliate firm. The BGA-ALA bundle is a function of the recombination capabilities by the individual affiliates. The recombination capability is their highest-order capability. This pertains to the capability of the affiliate firm to transfer and create new knowledge, integrate it with the existing knowledge base and exploit the resulting, new knowledge bundles across geographic space (Verbeke, 2009). Therefore, this bundle defines the overall advantage of each individual affiliate as well as the heterogeneity of the affiliates within a BG. The variance among ALAs occurs due to the level and extent of BGA recombination by each BG affiliate, that is, some affiliates operationalize or depend on BGAs greater than others since each affiliate has specific objectives, roles, operational scope and eventually competitiveness (Mahmood et al., 2011). Hence, the affiliates can use the BG structure to complement for the missing and potential advantages. This can be illustrated by looking at the strength and weakness of both BGAs and ALAs within the BG. The Figure 2 below depicts this dynamics using the BGA-ALA recombination matrix.

		Business Group Advantages (BGAs)	
		Weak	Strong
Affiliate-Level Advantages (ALAs)	Strong	3	1
	Weak	4	2

Figure 2. The dynamics of the BGA-ALA recombination by BG affiliates

The horizontal axis defines how strong or weak the BGAs are. These advantages are mostly available to affiliate firms in the BG. On the other hand, the vertical axis demonstrates the recombination capability of BG affiliates that is strong or weak. In general, the framework represents the four bundles of intragroup recombination by BG affiliates plus the assumed conditions of both home and host country CSAs. It suggests the heterogeneity of the BG affiliates as well as their propensity for internationalization. The first bundle, or quadrant, is where both BGAs and ALAs

are strong. In this bundle, an affiliate enjoys the best complementarities of BGAs and ALAs. These affiliates are somewhat the 'core elites' or the 'flagship firms'. These types of affiliates are likely to internationalize faster than the other affiliates. These affiliates have already crafted their ALAs to match the level of BGAs. The dependence on the BG is also strong here as the BGA-ALA bundle complimented very well with each other. Examples are those affiliates which have strong R&D or production technologies but would tap the strong distribution system of the group to further reduce their costs. The second bundle, or quadrant 2, is where BGAs are strong and ALAs are weak. Here, an affiliate mostly have BGAs and yet to start to develop its ALAs according to its role and operational objectives. This type of bundle requires the affiliate to build its advantages primarily on the BGAs. An example of this is an affiliate which has a potential to develop specific routines or products that goes well with its distinctive location and customer base. The third one is where ALAs are strong and BGAs are weak. This type of bundle illustrates the essence of the concept of 'independence' among BG affiliates. Here, an affiliate is almost able to decide on its own due primarily to its specific scope and role within the BG. It builds more on its ALAs rather than on BGAs. This means that the resources and capabilities of certain affiliates are very specific to them, which can be attributed to their distinct recombination of bundled advantages over time. The examples of these are those BG affiliated MNEs from Asia which serve as benchmarks for other affiliates (Chang and Hong, 2000). Some of these affiliates now operate in specialized industries which technology can be very different from the whole group. And lastly, the fourth is where both BGAs and ALAs are weak. This bundle essentially serves as a supplement to the core affiliates and operates in the periphery. Here, the recombination capability is also weak. The affiliates which possess this bundle are unlikely to pursue internationalization. All four bundles also represent the competitive position of BG affiliates within the BG. Therefore, each bundle corresponds to a certain pattern of internationalization, including the variety of modes of entry and operational scope.

Proposition 2: The business group advantages influence the development of the affiliate-level advantages

The Affiliate Level Advantages and Internationalization

The existing literature on emerging economy BGs is not clear on the dynamics of the internationalization of BGs or why we have *BG affiliated MNEs* within a BG. This is because there is no clear theory which explains the specific advantages of BG affiliates vis-à-vis their internationalization. The literature partly suggests that the degree of internationalization of BG affiliates is influenced by the moderating effects of BG affiliation (Chittoor and Ray, 2007). However, the concept of BG affiliation (measured as 1 being an affiliate and 0 otherwise), and its presumed effects, is different from the concept of BGA, since the affiliation to BGs does not always guarantee the advantages to individual affiliate firms. This

study builds on the above literature and proposes that the internationalization of BG affiliates is rather a function of their recombination of BGAs and ALAs. This recombination dynamics contributes to the distribution of the BGAs in the BG and influence the BG affiliates' internationalization decisions. The successful recombination provides a strong foundation for internationalization. Hence, the BGA is positioned here as one of the components of the overall advantages in the internationalization and international growth of BG affiliates over time (Elango and Pattnaik, 2007).

Proposition 3: The extent of the recombination of BGAs and ALAs by business group affiliates influences their degree of internationalization

Summary, Research Limitations and Future Directions

The analysis of the competitive advantages of EMNEs remains to be an interesting topic in the international business literature. This is important because the competitiveness of EMNEs influence the performance and international transactions of different firms across borders. This paper contributes to the above literature in two ways. Firstly, by focusing its theoretical analysis specifically on BGs as opposed to the entire emerging economy firms. This results to the clarification of certain kinds of EMNE advantages particularly those coming from the BGs. Secondly, the paper departs from the existing literature by formulating the internal dynamics of BGA instead of the typical analytical approach using the external institutions in the emerging economies. Hence, this is the first article to offer a comprehensive analytical framework in understanding the competitive advantages of BGs. Further, the theoretical framework that is presented here, particularly the BGA-ALA recombination matrix, offers a robust analysis on the internal relationships, capabilities and dynamics of the BG affiliates, regardless of whether they are in an emerging or developed economies; domestic or across borders.

However, while this paper is strong in theoretical grounding it has clear limitations with regard to empirical testing. Nevertheless, it offers some concrete measures of BG and affiliate level advantages which can rightly be tested using the research propositions of the paper. The future direction of this paper is promising. Firstly, the internationalization pattern of EMNEs can now be tested at the group level, as opposed to the typical single-firm level, by using the concepts of BGA, ALA and the recombination matrix. The future studies can compare the internationalization of BGs across different economies in terms of organizational configurations and ownership structure, diversification strategies and growth. Secondly, the concept of BGA and ALA can be applied to business groups which may later emerge from other types of economies such as the transition economies. The assumption is that the transition economies have many similarities with emerging economies where capital markets and other market institutions are still developing. Hence, the BG structure and advantages can emerge as an efficient approach to deal with various

market imperfections. Thirdly, the BGA and ALA can be conceptualized at the global level where the internal group dynamics will be measured not only from business group and affiliate levels but also including all the BG foreign subsidiaries across countries. This will have a broader picture and multi-level analysis of global entry modes, diversification and performance of different types of MNEs.

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PRZEWAGI KONKURENCYJNE ORAZ INTERNACJONALIZACJA GRUP BIZNESOWYCH WSCHODZĄCEJ GOSPODARKI

Streszczenie: Istniejąca literatura na temat konkurencyjności firm wschodzącej gospodarki nie w pełni rozróżnia rodzaje szczególnych zalet firmy, które wpływają na jej decyzje internacjonalizacyjne. Niniejszy artykuł odnosi się do powyższego poprzez skupienie się na wschodzącej gospodarce grup biznesowych i oferuje nowatorskie ramy teoretyczne odnośnie ich konkretnych zalet, wynikających z ich struktury organizacyjnej. Artykuł podąża za koncepcją możliwości rekombinacji i proponuje, że struktura organizacyjna i rynek wewnętrzny grup biznesowych są kluczem do zrozumienia dynamiki ich konkurencyjności i umiędzynarodowienia. Ponadto artykuł sugeruje, że zalety grupy biznesowej z upływem czasu mają wpływ na zalety poziomu partnerskiego i wielonarodowość grupową.

Słowa kluczowe: firmy wschodzącej gospodarki, grupy biznesowe, zalety grup biznesowych, zalety poziomu partnerskiego, internacjonalizacja

新興經濟體的企業集團的競爭優勢和國際化

摘要: 現有的對新興經濟體企業的競爭力文獻並沒有充分區分不同類型的企業特有的優勢，影響了公司的國際化決策。本文著眼於新興經濟體的企業集團企業解決了這一點，並提供了其特定的優勢了一種新的理論框架，從他們的組織結構產生。它適用的重組能力的概念，並提出了企業集團的組織結構和集團內部市場的關鍵在於了解自己的競爭力和國際化的動力。另外，文中認為，企業集團的優勢對子公司層面的優勢和集團多國性隨著時間的推移影響。

關鍵詞: 新興經濟體的企業，企業集團，企業集團的優勢，子公司層面的優勢，國際化。