Internationalization of Developing Country Firms into Developed Countries: The Role of Host Country Knowledge-Based Assets and IPR Protection in FDI Location Choice

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\textbf{ABSTRACT}

Foreign direct investment (FDI) from developing to developed countries is a widespread phenomenon in the global economy. The literature suggests that such investments frequently follow a motive to seek knowledge-based assets, with the goal of augmenting the firm's resource base through internationalization. We argue that the prevalence of this motive may direct developing country firms' FDI toward developed countries with relatively stronger knowledge-based assets and weaker intellectual property rights (IPR) protection and that this effect is amplified when both conditions coincide. Furthermore, we suggest that the respective importance of knowledge-based assets and IPR protection diminishes as developing countries augment their own knowledge-based assets and that the importance of asset seeking as an internationalization motive for the country's firms declines compared with other motives such as institutional escapism. We investigate our model with FDI data including investment flows from 85 developing countries to 35 developed countries during 2009–2014. We find that developing country firms prefer investing in developed countries with stronger knowledge-based assets and weaker IPR protection. These criteria attract even more FDI when both co-occur. Furthermore, the influence of weaker host country IPR protection on the location decision diminishes for firms originating from home countries with higher stocks of knowledge-based assets.

1. Introduction

Foreign direct investment (FDI) outflows from developing countries have grown significantly in the past decade. In 2014, multinational firms from developing countries invested US$468 billion abroad, constituting 35% of global FDI flows (United Nations Conference on Trade and Development [UNCTAD], 2015). Remarkably, 32% of these funds were invested in developed countries. Developing countries' FDI to developed countries attracts strong research interest because it entails overcoming high unfamiliarity (or distances) between markets, which can be further burdened by firms' lack of assets and limited experience with internationalization (Luo and Tung, 2007).

While FDI motives such as market seeking or resource seeking apply to general FDI flows, the literature has proposed two rationales to more specifically explain FDI from developing to developed countries: asset-seeking FDI (Dunning, 1993; Makino et al., 2002) and institutional escapism (Luo et al., 2010; Witt and Lewin, 2007). The asset-seeking motive stems from the observation that developed countries often have a higher endowment of sophisticated, knowledge-based assets than developing countries and thus
that firms from developing countries need to invest in developed countries to gain access to those assets (Dunning et al., 2008; Kedia et al., 2012). Despite these conceptual inroads, empirical investigations on the knowledge-based asset-seeking motives behind FDI from developing to developed countries have mostly been based on case studies (Deng, 2009; Lee and Slater, 2007) or single-country data, with inconclusive findings (Buckley et al., 2007; Kalotay and Sulstarova, 2010).

A related question concerns developing country firms' institutional preferences when they invest in developed countries. Do they prefer countries with higher or lower institutional standards? The institutional escapist view (Witt and Lewin, 2007) provides an immediate answer to this question by suggesting that some developing country firms invest in developed countries with rigid institutional frameworks (e.g., intellectual property rights [IPR] protection) to overcome the weak institutional environments in their home country (Khanna and Palepu, 2006; Luo et al., 2010; Yamakawa et al., 2008). Less clear, however, is the institutional preferences of developing country firms if they follow a knowledge-based asset-seeking motive through internationalization. On the one hand, they might seek rigid IPR protection to protect their newly acquired knowledge-based assets. On the other hand, they might seek countries with relatively weaker IPR protection to benefit from knowledge spillover effects in addition to the knowledge-based assets they directly acquire. Empirical evidence on the influence of host country institutions on developing country firms' FDI location choice is scarce. Most studies examining the institutional determinants of FDI from developing countries have focused on the influence of home rather than host country institutions (Geleilate et al., 2016; Wu and Chen, 2014; Yiu et al., 2007).

Considering these voids, we investigate the role of host country knowledge-based assets and IPR protection in the location choice of developing country firms' investments, by testing our hypotheses using a large set of FDI data for the years 2009–2014 that contains investments from 85 developing countries to 35 developed countries. We focus on knowledge-based assets, such as human capital, research, technology, and creative outputs, because the availability of these assets strongly differs between developing and developed countries and the literature has specifically pinpointed knowledge-related aspects when describing asset-seeking motives of developing country firms (Dunning, 1998; Kedia et al., 2012; Makino et al., 2002). We also explore whether the influence of host country IPR protection is further augmented when it coincides with strong knowledge-based assets in the home country to test the specific relevance of weaker host country IPR protection for FDI following an asset-seeking motive. Finally, we explore whether the availability of knowledge-based assets in the home country negatively moderates the two first hypotheses. By testing the moderation effects, we aim to show how the dynamics of FDI from developing countries may evolve in the future as their own assets grow.

We aim to contribute to the literature in several ways. First, confirmation of our hypotheses would lend empirical support to the relevance of the knowledge-based asset-seeking motive in developing country firms' investments in developed countries (Dunning, 1993; Luo and Tung, 2007). Second, our study sheds light on the institutional preferences, particularly for IPR protection, when developing country firms invest in developed countries and how these preferences depend on the knowledge-based assets endowment in the host country. Third, we delve deeper into the contingencies and boundary conditions under which the knowledge-based asset-seeking motive and preference for weaker host IPR protection hold as location decision criteria for FDI from developing to developed countries.

The remainder of this paper proceeds as follows: Section 2 presents the theoretical background, and Section 3 unpacks the hypotheses. Section 4 provides the methodology, and Section 5 discusses the results. Section 6 concludes with a discussion of the implications of the findings, limitations of the study, and suggestions for further research.

2. Theoretical background: asset-seeking FDI and institutional factors in location choice

One of the cornerstones of the literature on firm internationalization is the eclectic paradigm, or OLI framework. This perspective, developed by Dunning (1980, 1988, 1991, 2000), proposes that the three factors of ownership advantage, location advantage, and internalization advantage together determine firms' internationalization decisions. Ownership and internalization advantages are attributes of the firms themselves, with ownership advantages describing superior resources or capabilities of a firm and internalization advantages meaning a preference for keeping activities in-house rather than outsourcing them to other firms. By contrast, location advantage refers to location-specific conditions of home and host countries, such as market size, availability of natural resources, labor, or other assets that firms require to operate successfully. Following this logic, firms are likely to choose FDI as a strategy of internationalization if both locational advantages of the host country and internalization advantages are high. Furthermore, investing firms seek to pursue market success in the host country using their superior ownership advantages (market-seeking FDI), to acquire these advantages through investments in the host country (resource-seeking and asset-seeking FDI) or to capture efficiency improvements through, for example, economies of scale or cheaper production inputs (efficiency-seeking FDI) (Brouthers et al., 2008; Makino et al., 2002; Nachum and Zaheer, 2005).

While some of these motives, such as market seeking and natural resource seeking, are frequently observed in FDI flows between all kinds of countries regardless of their state of development, the asset-seeking motive is proposed to be particularly relevant for FDI coming from developing to developed countries (Dunning, 1993; Makino et al., 2002). Building on the original work of Dunning (1993), scholars have argued that developing country firms might engage in FDI to overcome asset-related disadvantages rather than to exploit existing advantages (Cui et al., 2014; Deng, 2009; Rui and Yip, 2008). In a similar vein, Dunning (1991) describes strategic asset seeking as the desire to create or gain access to resources and capabilities that complement their existing core competencies. Frequently, asset-seeking FDI involves the acquisition of knowledge-based resources such as technology, product concepts, brands, and managerial know-how (Cui et al., 2014; Makino et al., 2002). For example, Chinese companies establish R & D subsidiaries in developed countries to take advantage of innovation clusters (Deng, 2007). Similarly, Korea's Samsung Electronics acquired foreign companies and licenses early in its development to upgrade its memory chip technology (Lee and Slater, 2007). More recently, Indian firms have actively been making cross-border acquisitions to facilitate internalization of tangible and intangible resources (Gubbi
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