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Host–home country linkages and host–home country specific advantages as determinants of foreign acquisitions by Indian firms☆

Peter J. Buckley [a], Nicolas Forsans [b,*], Surender Munjal [a,c]

[a] Centre for International Business, University of Leeds (CIBUL), Leeds University Business School, Leeds, United Kingdom
[b] James E Lynch India & South Asia Business Centre, Centre for International Business, University of Leeds (CIBUL), Leeds, United Kingdom
[c] Moti Lal Nehru College (E), University of Delhi, New Delhi, India

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A B S T R A C T

This paper examines the complementarity of country-specific linkages with country-specific advantages in explaining the foreign acquisitions by Indian MNEs by testing and extending further the Eclectic Paradigm. The approach to internationalisation dominated by the Eclectic Paradigm has constantly faced challenges in gaining acceptance as a holistic framework in explaining outward foreign direct investment (OFDI). In 2006 Dunning acknowledged that the role of networks and linkages (Dunning, 2006a). In this paper we explore the view that linkages between host and home country should be included in the Eclectic Paradigm as institutional assets. Country-specific linkages add to richness and improve explanatory power of the Eclectic Paradigm. Linkage variables are shown to be an adjunct to the Eclectic Paradigm, not an alternative to it.

1. Introduction

While global outward foreign direct investment (FDI) flows are dominated by developed country multinational enterprises (MNEs) India and China have emerged as significant investors abroad. The stock of China's outward FDI increased from $27 billion in the year 2000 to $230 billion by the end of the year 2009 (UNCTAD, 2010). While corresponding figures for India are much lower, India's OFDI has substantially increased since the late 1990s to amount to $77 billion by the end of the year 2009. While Dunning's Eclectic Paradigm (Dunning, 1977, 1980, 1985) was developed in the context of FDI undertaken by developed country MNEs, academics and commentators have raised concerns about the applicability of the framework to FDI by emerging country MNEs (eMNEs) (Mathews, 2006). Rugman (1981, 1985, 2005) divides the ownership, location, internalisation (OLI) configuration of the Eclectic Paradigm into firm-specific advantages (FSAs) and country specific advantages (CSAs). This paper tests the Eclectic Paradigm of international expansion by multinational enterprises (MNEs) by concentrating on country specific factors and extends these explanatory elements by including host–home country linkages.

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* Corresponding author at: James E Lynch India & South Asia Business Centre, Centre for International Business, University of Leeds (CIBUL), Leeds, United Kingdom. Tel.: +44 (0)113 343 4497; fax: +44 1133434754.
E-mail addresses: P.J.Buckley@lubs.leeds.ac.uk (P.J. Buckley), N.Forsans@lubs.leeds.ac.uk (N. Forsans), S.Munjal@lubs.leeds.ac.uk (S. Munjal).

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In 2006 Dunning proposed to incorporate institutional assets into the Eclectic Paradigm, as these can create competitive advantages for internationalisation (Dunning, 2006b). This paper, while testing the Eclectic Paradigm incorporates a novel angle of institutions, i.e., host–home country linkages. Dunning (2006a, p. 140) acknowledged that globalisation "*is opening up a whole new set of opportunities for all types and sizes of firms*, (. . .) *cross border linkages* (. . .) *can be an important raison d'etre for outbound MNE related activity*". In a globalising world, networking and linkages are becoming critical for multinational firms (MNEs). Using network and linkage strategies emerging multinationals are integrating into global value chains (Mathews, 2006). In this respect, country-level strategic partnerships can enable firms in partner countries to benefit from mutual cooperation of their countries. There are several examples of country-level strategic linkages such as the G-20 and the Commonwealth. This paper also tests country-level linkages and investigates their power as determinant of international expansion. Thus, our paper tests the explanatory power of CSAs and goes on to examine the extra degrees of explanatory power given by linkage variables.

To do this, we examine the foreign acquisition behaviour of Indian MNEs. India is a particularly good case to conduct this test for a number of reasons. First, Indian MNEs possess unique CSAs stemming from a number of home country characteristics, and at the same time India has both south–south and north–south linkages (country specific linkages or CSLs) through her membership of international fora. Second, despite the country's growing economic significance India has remained under-researched as a result of the paucity of data.[1] Using a panel dataset on foreign acquisitions this study attempts to fill an empirical gap by improving our understanding of the drivers of OFDI from India, and a theoretical gap by improving the specification of commonly used models of the determinants of outward FDI.

The reminder of this paper is organised as follows. In the next section we briefly review the literature on country-specific advantages, linkages between home–host countries, and host country location advantages. The following section presents the methodological framework and finally the empirical results are discussed.

2. Theory and hypotheses

In this section we review the literature and formulate hypotheses on home country specific advantages, host country specific location variables and home–host country linkages.

2.1. Home country-specific ownership advantages (CSAs)

There is a long tradition dating back to Ricardo (1973) of differentiating the world into nation states and examining the global economy by reference to interaction between sovereign nations. Theories of the competitive advantage of nations (Porter, 1990) imply that firms in specific countries can benefit from unique locational advantages. A country's institutions and its macro-economic environment (Kojima, 1973, 1975, 1978) may become sources of competitive advantages if firms can internalise these features and transform them into mobile assets (Buckley & Casson, 1976; Casson, 1979; Dunning, 1977, 1985; Rugman, 1981, 1985).

The transformation of home country specific advantages into firm-specific advantages (FSAs) is an underexplored area in international business theory. However, home country effects are often strong in explaining outward FDI (see for example Buckley et al., 2007). Firms domiciled in particular locations have access to home country attributes that are closed to outsiders. This applies both (strongly) to firms that are not present at all in the country and (less strongly) to foreign firms located there. In a recent study of the internationalisation of Indian MNEs Balasubramanyam and Forsans (2010) found that Indian firms that have ventured abroad through FDI possess a unique set of advantages that are grounded in India's recent history of industrialisation and the emphasis placed on tertiary education. The barriers to outsiders gaining access to CSAs are obvious insofar as they depend (by definition) on presence in the country conferring the CSA. Barriers to foreign firms present in the country include legal issues, local firm preference (by government but possibly also by consumers and the civil society), cultural barriers and strong internal networks (clans, families, political parties) designed to excluded non-locally owned firms.

Country-specific variables that might give firms domiciled in that location particular advantages in international competition include the domestic capital market (which may make capital available to local firms at a lower cost), the foreign exchange rate (a strong exchange rate makes foreign assets cheaper) and the English language (reducing transaction costs in English speaking host countries).

2.1.1. Domestic capital market

The home stock market can be an important source of finance. Stock market valuations were found to have significant explanatory power for U.S. investments abroad (Barrow, 1990) as MNEs make extensive use of their internal capital market to finance FDI projects (Herzer, 2008). Baker, Foley, & Wurgler (2009) found that FDI flows are strongly related to the home country's stock market valuation, as high stock valuations at home make financing cheaper by reducing the cost of capital. The association between stock market valuations and FDI is a strong one. As Baker puts it, "*the effect of source*

[1] Official data on Indian OFDI is seldom available and is of very poor quality. Some authors such as Pradhan and Kumar have complied data form unpublished sources, newspapers, business magazines, but the quality of data is always a consideration.