



Internationalization, Innovation and Institutions: The 3 I's Underpinning the Competitiveness of Emerging Market Firms

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ABSTRACT

The past decade has seen an increase in the extent of research focused on and around emerging market firms (EMFs) and their rising levels of competitiveness in both their home markets and more importantly in the global market place. At the same time, the practitioner-oriented literature has been documenting a growing number of corporate success stories that originate in emerging market economies. We posit that the growing prominence of EMFs is a result of three interrelated phenomena: the fast-paced *internationalization* of EMFs into both developing and developed market economies; the rapidly increasing extent to which business enterprises in emerging economies are focusing on knowledge-intensive processes and *innovation*; and the continuous evolution of *institutions* in these markets, particularly in terms of economic liberalization.

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1. Introduction

Based on Eyring et al. (2011) “more than 20,000 multinationals are operating in emerging economies”, while Mathew (2011) adds that “the number of BRIC companies on the *Financial Times 500* list [has] more than quadrupled” between 2006 and 2008 alone.¹ Further evidence can be found in The Global Competitiveness Report (World Economic Forum, 2009, 2010, 2011) in which we have seen the continuing increase in the competitiveness levels of most large developing economies, the most prominent being the BRIC nations. However, this increase is also observed in many of the smaller strong-growth economies (e.g., Cambodia, Vietnam and even a few African economies), which have moved up the ranks over the past few years. It is important to understand the phenomena underlying this drastic change in the distribution of global competitiveness. In the following discussion, we introduce some key definitions and arguments. Subsequently, we provide a selection of case examples of how these phenomena can manifest themselves in the real world. We develop the structure of the 3 I's view (i.e., internationalization, innovation and institutional change), drawing on examples that highlight the dynamic interaction between those factors.

2. Internationalization

Companies in developed economies have gone and still are going international for the same reasons EMFs are following suit today. Advances in technology have facilitated, but also demanded an internationalization of firms around the globe and in particular the emerging and developing economies. The reasons underlying these arguments are varied, ranging from falling trade barriers, through saturation of local demand to a necessity for international economies of scale (Mudambi, 2008). As emphasized in a recent Ernst and Young (2011) report, the rapid growth of emerging economies and favorable changes in domestic policies over the past decade have further nurtured this trend and this phenomenon is not restricted to EMFs from BRIC nations. While the

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¹ The BRIC countries are Brazil, Russia, India and China. The acronym was originally coined by O'Neill (2001).

management literature appears to accept the fact that internationalization has become a standard requirement for successful business, its engagement with the issues involved (with some notable exceptions like Contractor et al., 2003) primarily focuses on specific corporate success stories rather than on the wider range of topics in this area of inquiry. This makes 'internationalization' the one 'I' with the highest discrepancy in coverage as between academic and practitioner-related literature.

Success stories of EMFs' internationalization are plentiful in the practitioner-oriented literature. JBS SA, is Brazil's largest multinational and it has become the world's largest beef processor in just six years (Smith, 2009). The family-controlled company grew through international expansion and a streak of 13 acquisitions into one of the 2000 largest companies worldwide and is currently ranked 766th (Blankfeld, 2011). Using a global 'roll-up' strategy the company has re-invented business in its industry reaching new heights in terms of scale, bargaining power and profitability (Smith, 2009). Mittal Steel (today ArcelorMittal) applied the same strategy and is today the world's largest steel company, ranked 74th on Fortune's (2011) 'Global 500' list. From its first internationalization in 1989 it took the company little over two decades to revive a flagging industry, then considered the "troubled stepchild of global industry" (Reed, 2007). Both companies had aggressively expanded into both developed, emerging and developing economies.

3. Innovation

Recently, the *Wall Street Journal* (2011) posted a video on its website showing just how much 'innovation' is perceived as a driver of competitiveness among corporate executives and how economies such as China are increasingly becoming stronger at generating them. Washburn and Hunsaker (2011) echo this perspective, claiming "multinationals that continue to ignore emerging markets' potential for innovation will be left behind". China as the largest developing economy is no longer just a hub for manufacturing, but increasingly is becoming a hub for innovation as well. Citing Dow Chemical CEO Andrew Liveris the company is employing 500 scientists in China with a per capita innovation output (measured in patents) already higher than it is for the company's scientists elsewhere. The video also made mention of the Global Competitiveness Report addressed earlier, stating that China has consistently moved up the ranks over the past three years while the United States (U.S.) lost ground over the same period.

In fact, a "key phenomenon of the early twenty-first century is the rise of emerging markets as players in extant global R&D networks" (Mudambi, 2011: 317). Innovation in and from developing economies has become a significant component of global innovative output and further embellishes the increasing competitiveness EMFs attain in the global market place. *Businessweek's 50 Most Innovative Companies* (2010) has seen companies such as China's BYD and India's Reliance Group join the top of the list. Many such firms are even able to maintain an innovative output at a level that enables them to compete with global leaders in the relevant industries. For instance, Suzlon, an Indian wind turbine company was established in the mid-1990s and became one of the leading global players in its industry within eight years (Awate et al., 2012).

Few companies even in the advanced economies display as intense a focus on continuous innovation as Infosys does. Born on the idea of seven entrepreneurs to make an impact to the U.S. dominated software coding business, Infosys has been ranked 15th in *Forbes'* (2011) 'The World's Most Innovative Companies' list and has won the 'Global Most Admired Knowledge Enterprise' (Global MAKE) award multiple times and admitted to the award's 'Hall of Fame'. Pioneering the 'Global Delivery Model' the company has been able to offer software development for corporations with most of the work done at locations offering the best combination of talent, quality and cost. The company has done all this while "blending the science of software with the art of consulting" (Govindarajan and Trimble, 2011) and being honored recently by the *Wall Street Journal* (2010) as India's most-admired company.

Such success stories are almost always sparked by the local knowledge sourcing activities of competence-creating multinational firm subsidiaries (Cantwell and Mudambi, 2011). The associated knowledge spillovers are facilitated by rising connectivity between emerging and advanced economies, both through organizational (often MNE) 'pipelines' and personal relationships (Lorenzen and Mudambi, forthcoming). The former are frequently kick-started through the offshoring activities of multinational firms (Contractor et al., 2010), while 'diasporas' of international migrants often fuel the latter. Nowadays successful businesses no longer need a manufacturing plant, but can be launched from a single computer. The result is a healthy entrepreneurship level that acts in parts as a driver of innovation, even if at times only considered as 'microinnovations'² (Ramstad and Chao, 2011).

4. Institutions

Institutions and their evolution are strong factors supporting the increased competitiveness of emerging markets and their EMFs. Taking Singapore as an example – a country described by Crane (2007) as "the easiest country in the world to start and run a business" – one can start to understand how the institutional environment builds the fundamentals on which EMFs are born and thrive. In addition to low bureaucracy and a vast supportive infrastructure for businesses, Singapore is actively promoting education and knowledge. This includes the funding of overseas studies for its citizens and persuading scientific leaders and innovation drivers to work in this island economy (Kao, 2009). Singapore provides the best blueprint for how governments can positively influence the competitiveness of their companies, by embracing innovation as a national priority.

Perhaps one of the most significant current examples of increased EMF competitiveness – as fostered by institutional change – is the case of the Commercial Aircraft Corporation of China (Comac). With Comac the People's Republic has made "aircraft

² Ramstad and Chao (2011) define 'microinnovations' as those innovations that primarily improve on existing business models found in the West or are simply adaptations of these to the local market.

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