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Entry and access to competencies abroad: Emerging market firms versus advanced market firms

Filip De Beule [a,1], Stefano Elia [b,*], Lucia Piscitello [b,2]

[a] University of Leuven (KU Leuven), Korte Nieuwstraat 33, 2000 Antwerpen, Belgium
[b] DIG-Politecnico di Milano, P.za L. da Vinci 32, 20133 Milano, Italy

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ABSTRACT

This article examines the acquisition behavior of multinational companies from emerging markets (EMNCs) compared to multinational companies from advanced markets (AMNCs). Specifically, we relate the governance mode (i.e. the degree of commitment) to exogenous and endogenous uncertainty. As a result of endogenous uncertainty due to their liability of origin, EMNCs are likely to acquire less control, which is exacerbated by exogenous uncertainty when acquiring targets in high-tech sectors. Furthermore, EMNCs experience a higher propensity to control the local partner the higher the institutional distance with the host country, since they enjoy a better institutional environment when they invest in advanced countries and, hence, they are less likely to need a local partner. To test our hypotheses, we develop an econometric analysis applied to foreign acquisitions in Italy between 2001 and 2010 and we study the degree of control of AMNCs as compared to EMNCs. Our results confirm that EMNCs acquire less control than AMNCs, especially in high-tech industries, while institutional distance in trade and investment freedom effectively increase the probability to undertake full acquisition for EMNCs as opposed to AMNCs.

1. Introduction

This article is about ownership strategies of foreign multinationals acquiring firms in advanced economies. In particular, it examines the acquisition behavior of multinational companies from emerging markets (EMNCs) compared to multinational companies from advanced markets (AMNCs) in Italy. EMNCs that acquire firms in advanced countries go against the grain of conventional wisdom about the direction in which capital, technology, and knowledge should flow in the global economy. And it represents a situation which extant international business theory fails to explain well (Mathews, 2006). EMNCs supposedly use international expansion in advanced countries as a springboard to compensate for their competitive disadvantages. In order to compete internationally, they need to overcome their own weaknesses quickly. Therefore, they aim to acquire capabilities and technologies such that they do not need to develop the same internally. Previous studies (e.g., Luo and Tung, 2007) have already shown that when investing in developed countries, EMNCs seek sophisticated technology or advanced manufacturing know-how by acquiring foreign companies. Namely, EMNCs outward investments are triggered mainly by 'pull' factors, such as the desire to secure critical resources, acquire advanced technology, obtain managerial expertise, and gain access to consumers in key foreign markets, so that they can overcome their latecomer disadvantages (Mathews, 2006).

* Corresponding author. Tel.: +39 02 2399 2756; fax: +39 02 2399 2710.
E-mail addresses: filip.debeule@kuleuven.be (F. De Beule), stefano.elia@polimi.it (S. Elia), lucia.piscitello@polimi.it (L. Piscitello).
[1] Tel.: +32 3 201 18 83; fax: +32 3 201 18 99.
[2] Tel.: +39 02 2399 2740; fax: +39 02 2399 2710.

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In general, EMNCs are eager to acquire technology and brands through internationalization to fill their resource void. Foreign firms' willingness to sell or share their technology, know-how or brands due to financial exigency or restructuring needs makes it possible for EMNCs to fulfill this need (Child and Rodrigues, 2005).

Although most multinationals come from advanced countries, EMNCs have made a remarkable entrance on the international scene in the last decade. Since the 1990s, in both developed and developing countries, M&A have become a more important component of inward and outward FDI. However, although EMNCs have the ambition to become global players, their pattern of international expansion is supposedly different to that of their developed world counterparts (Guillen and Garcia-Canal, 2009). In fact, EMNCs have been relatively more successful in penetrating other developing countries, but relatively less successful in entering developed countries (Cuervo-Cazurra and Genc, 2008).

Meyer et al. (2011) attribute the relative success of EMNCs to capabilities that they have developed in order to deal with the specific conditions of their home environment. The institutional and economic environment of developing countries differs from that of developed countries. In order to be competitive at home, EMNCs develop capabilities that allow them to deal with their home market specificities (Van Assche, 2011). These abilities may then provide EMNCs with a competitive advantage when expanding into countries with similar conditions. That is why it is suggested that, ceteris paribus, EMNCs are more likely to invest in countries with similar market and institutional characteristics. That is, EMNCs generally tend to invest in other less developed countries as the investing firms can rely on their firm-specific advantages which are better adapted to the needs and institutions existing in other developing countries.

In a similar, yet contradictory vein, EMNCs suffer from a disadvantage when investing in advanced economies. The liabilities of origin can make the EMNC's task of acquisition of legitimacy in the advanced host country market far more difficult (Yildiz, in press). EMNCs find themselves subjected to discrimination by competitors, consumers, and even by governments, in advanced markets due to prevailing biases against practices, products and services associated with developing and emerging economies. Crucially, this liability of origin can be particularly important when the firm has yet to build up its own reputational capital, as is usually the case with EMNCs seeking a foothold in advanced markets. EMNCs may also suffer as a result of the misgivings of host governments, whose officials may be reluctant to encourage EMNCs in their markets either due to geopolitical considerations, or simply because they lack confidence in their capabilities (Pant, 2012).

The second type of disadvantage faced by EMNCs in advanced markets can be traced to the underdeveloped home country institutions. Given their institutional disadvantage in entering advanced markets, they are again likely to be affected in their strategic behavior. The distinctive challenges confronted by EMNCs in advanced country markets can shed light on how location (i.e., the country of origin) can shape the legitimacy of firms in international markets, which emerges from its ability to persuade businesses in the host country institutional environment.

Therefore, in order to analyze and compare the respective acquisition behavior of EMNCs and AMNCs, we carried out an econometric analysis on foreign acquisitions in Italy during the decade 2001–2010. The availability of such a sample allows us to analyze the uniqueness of EMNCs' behavior and to compare their entry choice with AMNCs.

This work is original in various respects. Although both the literature on the MNCs' entry mode and the studies focusing on EMNCs are vast, the latter's entry strategy in developed countries has not received much attention so far. Here, we focus on factors explaining the degree of ownership in local companies acquired by EMNCs. Namely, thanks to a detailed database for Italy, we compare EMNCs with AMNCs, thus addressing the crucial issue of "the unique or special features of the home country environment" influencing international entry mode (Brouthers and Hennart, 2007; Li and Peng, 2008).

Additionally, MNCs' entry mode choice has been widely investigated by international business scholars mainly focusing on determinants and patterns of the choice acquisitions vs. greenfield initiatives, or wholly owned subsidiaries vs. joint ventures (for recent reviews, see Dikova and van Witteloostuijn, 2007; Hennart, 2009). Instead, we focus on the level of control and the equity share in cross border acquisitions, an issue that has not received much research attention so far (for an exhaustive survey and discussion, see Chari and Chang, 2009).

The paper is organized as follows. The next section presents our conceptual framework and testable hypotheses. The third section presents the data and descriptive statistics, while econometric models and variables employed are reported in the fourth section. The fifth section illustrates and discusses the results, while the final section summarizes the main contributions of the paper.

2. Conceptual background and hypotheses

Multinationals are increasingly seeking to augment, as well as to exploit, their global competitive advantage. The emergence and growth of asset-seeking and competence-creating MNC activities, which aim not only to exploit a particular set of ownership-specific advantages but also to access new ones, is driving firms to acquire target firms abroad. In particular, acquisitions are being used in order to augment the competitive ownership-specific advantages of the investing companies by exploiting and accessing the capabilities and resources of particular companies. Due to the growing importance of knowledge as the fundamental rationale for investment, foreign entry by acquisition of local companies has increasingly become the primary fashion by which MNCs access complementary resources, information and knowledge otherwise hard to obtain (Anand and Delios, 1997; Meyer et al., 2009a, 2009b; Phene et al., 2012). In fact, there is ample empirical evidence to suggest that MNCs use acquisitions to procure a wide variety of proprietary assets from indigenous firms (Caves and Mehra, 1986; Hennart and Park, 1993) and several studies have identified the access to knowledge as a major motive for foreign acquisitions of multinational companies abroad (Anand and Delios, 2002; Anand and Kogut, 1997; Chen and Hennart, 2002; Florida, 1997; Kuemmerle, 1999).