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# Key factors affecting acquisition of technological capabilities from foreign acquiring firms by small and medium sized local firms[☆]

Byung Il Park[a,1], Pervez N. Ghauri[b,*]

[a] Hankuk University of Foreign Studies, College of Business Administration, 270, Imun-dong, Dongdaemun-gu, Seoul 130-791, South Korea
[b] King College London, Strand, London WC2R 2LS, UK

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ABSTRACT

The objectives of this study are to investigate whether foreign acquiring firms contribute towards enhancing technological capabilities of local firms in foreign markets. Given that drivers promoting technology acquisition from acquiring firms have been largely neglected in the literature, we attempt to identify the key factors influencing this phenomenon. Secondly, although several studies have discussed knowledge exchange through international acquisitions (IAs), little attention has been given to small and medium sized local acquired firms (SMLFs). By using three dimensions of organizational characteristics based on absorptive capacity, our empirical evidence reveals three key findings. First, to develop an effective absorptive capacity, mere exposure to favorable learning environments is not sufficient, and that intensity of effort is a critical component functioning as a facilitator towards the extent of learning. Second, what is already known can be improved when partners share similar business background. This is because the possession of relevant knowledge based on business relatedness increases the boundary of curriculum in organizations. Third, collaborative support from knowledge transferors is a significant catalyst generating a specific learning capability.



## 1. Introduction

International acquisitions (IAs) are considered as an important mode of foreign entry and are now fully incorporated in the internationalization strategy of firms. Chen and Hennart (2004) define IAs as strategic investments undertaken to promptly penetrate into target markets by acquiring partial equity of existing local firms. As the investment requires partial ownership participation based on cooperation with existing local firms, the entry mode offers various advantages to multinational enterprises (MNEs) which do not possess sufficient information on the target markets. For example, uncertainties stemming from operations in unfamiliar markets can be tackled by local firms. Complementary resources (including locally resident knowledge) provided by local firms can be shared with MNEs. Due to these benefits, the volume of IAs has been increasing rapidly as a form of foreign direct investment (FDI). Anand and Delios (2002) indicate that more than half of recent FDI into the USA was made in the form of IAs. Newburry and Zeira (1997) argue that IAs are not only a popular form of investment in the USA, but is prevalent worldwide. According to Ivarsson and Vahlne (2002), such predominance has become a detonator replacing Greenfield investments as the most common mode of entry into foreign markets.

Moreover, IAs have several potential positive influences on firm competitiveness for local target firms (Hitt, Harrison, Ireland, & Best, 1998). First, the local firm significantly improves market position through increased market share. Second, the local firm obtains economies of scale and/or scope by blending complementary capabilities of the two firms. Third, the local firm can access capital at lower costs. Perhaps, most importantly, the local firm can have an opportunity to learn foreign technology through the IA. Some scholars emphasize the technology acquisition motivation drives the acquiring firms rather than local firms. For example, Anand and Delios (2002) argue that firms owning few technological capabilities are likely to attempt to obtain technology by acquiring innovative local firms. These advantages must be sufficient to compensate for the costs of operating in unfamiliar foreign markets. They may include intangible firm-specific resources, such as advanced technology and management know-how (Georgopoulos & Preusse, 2009), which may motivate direct international expansions through acquisitions (Hitt et al., 1998).

Despite the recent prevalence of IAs and the general consensus on the importance of technological exchanges, technology acquisition in cross-border acquisitions has received scant

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* Corresponding author. Tel.: +44 20 7848 4122.
*E-mail addresses:* leedspark@hufs.ac.kr (B.I. Park), pervez.ghauri@kcl.ac.uk (P.N. Ghauri).
[1] Tel.: +82 2 2173 3193; fax: +82 2 964 3532.

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attention. Although there are some exceptions that view that technological knowledge is shared between partners in IAs (e.g., Vermeulen & Barkema, 2001; Very & Schweiger, 2001; Zou & Ghauri, 2008), we approach this issue from a different angle (i.e., knowledge acquisition from acquiring firms by local firms). The work of Bresman, Birkinshaw, and Nobel (1999) being a special case, but their examination refers to an international merger.

Tsai (2001) argues that large subsidiaries usually have some advantages in gaining the parents' support for their business activities and innovative operations, which often functions as a stimulant enhancing organizational absorptive capacity. Similarly, Simonin (1997) finds that firm size is a critical element significantly influencing collaborative sharing of experience between partners. For these reasons, Shenkar and Li (1999) suggest that the large subsidiaries should have more relevance to the knowledge acquired from the foreign firms than the smaller ones. According to Minbaeva, Pedersen, Bjorkman, Fey, and Park (2003), firm size represents the level of strategic position, and thus a stronger strategic position allows better access to knowledge and other resources.

These discussions imply that large organizations usually own high level of absorptive capacity or organizational capabilities to develop it. On the other hand, small and medium sized enterprises (SMEs) may not have such a competence. We believe that it is worth identifying mechanisms and illuminating key factors affecting absorptive capacity particularly in these firms. However, it is hard to find empirical examinations focusing on absorptive capacity in SMLFs. The objectives of this study are twofold. First, this study considers the role of foreign acquiring firms in contributing technological capabilities to IAs in target markets. Second, this study identifies factors influencing the phenomenon.

## 2. Theoretical background

One perspective suggests that MNEs are to a large extent devoted to exploiting internally embedded knowledge and exploring new information through cross-border investments to increase sustainable competitive advantages in global markets (Barkema, Shenkar, Vermeulen, & Bell, 1997; Hamel, 1991; Pak, Ra, & Park, 2009; Tsang, 2002). Meanwhile, the MNEs' direct investments expose their proprietary knowledge, which creates a potential for technology and knowledge transfer to the host country (Lyles & Salk, 1996). Knowledge transfer by MNEs is a particularly crucial phenomenon in the relatively less developed host economies. For these firms, it becomes a strategically important source for the local firms to learn foreign technology and know-how. However, Cohen and Levinthal (1990), who coined absorptive capacity, argue that firms attempting to acquire new knowledge need to possess three dimensions of firm-specific capabilities to efficiently absorb such external skills: (1) ability to understand new knowledge, (2) ability to assimilate new knowledge, and (3) ability to apply it to commercial ends.

Lyles and Salk (1996) shed light on the firm-specific characteristics as a key prerequisite to understand other firms' organizationally embedded knowledge that an organization neither has nor can develop. In the same vein, Cohen and Levinthal (1990) suggest that the understanding of complex knowledge is highly dependent upon existing own knowledge with the basis of various *firm-specific resources*. These internal resources increase the firm's ability to accurately evaluate and recognize tacit information. According to Lane and Lubatkin (1998), a firm's unique internal resources help the knowledge acquirer to rapidly appreciate relevant basic knowledge and facilitate additional understanding and appropriate appraisal of other incoming knowledge flows.

*Trust* relationship provides an efficient basis for absorptive capacity in an entity such as IAs requiring collaboration between foreign and local firms. As foreign and target firms coupled into the formation, they will not attempt to guard 'crown jewels'. This significantly contributes their exchange of valuable knowledge and eventually enhances organizational capability to assimilate new information. Trust raises the level of confidence that the other firm will not make decisions detrimental to the IAs (Lane, Salk, & Lyles, 2001). Lane and Lubatkin (1998) further argue that if a knowledge acquirer wishes to assimilate some of the valuable skills possessed by another firm, its ability to synthesize new information will be greater when they have similar systems. They suggest that *compatible characteristics* between the firms that transfer and acquire knowledge have a positive effect on absorptive capacity. Anh, Baughn, Hang, and Neupert (2006) indicate that differences in organizational culture are a major hindrance to knowledge acquisition, as they create various problems particularly in organizations requiring cooperation between foreign and local firms.

Cultural boundaries often generate communication difficulties, unsuccessful negotiations and time-consuming problem solving and lessen the opportunities for knowledge sharing. In addition, Cohen and Levinthal (1990) concluded that acquisition of new external knowledge is virtually impossible without possession of prior related knowledge. Anh et al. (2006) describe prior related knowledge as various knowledge domains such as cognitive structure, basic skills, problem solving methods and prior learning experience. Business relatedness between acquiring and target firms suggests that common sharing of prior knowledge is closely associated with information domains possessed by them (Lane & Lubatkin, 1998; Lane et al., 2001).

Finally, in the case where organizations trying to learn from external sources are not established in developed countries, they generally face difficulties with complete acquisition of new knowledge from transferors due to lack of capability to sufficiently use the provided learning opportunity (Hitt, Dacin, Levitas, Arregle, & Borza, 2000). In this regard, Park (2010) argues that *knowledge possessor's collaborative support* is essential for an acquirer to efficiently seize the learning opportunity and connect knowledge absorption to commercial ends. Knowledge acquisition literature using the absorptive capacity concept often addresses active participation in management support (Lane et al., 2001; Tsang, 2002) and dispatch of foreign expatriates in key functional areas (Park, Giroud, Mirza, & Whitelock, 2008; Tsang, 1999a).

## 3. Model and hypotheses development

Building on the concept of absorptive capacity (Cohen & Levinthal, 1990; Lyles & Salk, 1996), our framework illustrates the components previously discussed in the relevant literature (Fig. 1). Based on the prior research, we argue that three fundamental constructs influence technology acquisition in SMLFs: Firm-specific resources of knowledge acquirers, trust and organizational compatibility and collaborative support by knowledge transferors.

### *3.1. Firm-specific resources of knowledge acquirers*

#### *3.1.1. Human capital*

It is generally difficult for SMEs to possess distinctive resources that enable them to compete effectively against larger firms. The value of human capital (i.e., the quality of employees) determines how fast organizations recognize advanced external knowledge and utilize a given learning opportunity (Park, 2010). Larger firms tend to have an advantage over smaller firms due to the overall number of employees from whom to draw educational and personal knowledge. Ling and Jaw (2006) suggest that human capital consists of people with collective knowledge, skills, abilities, expertise, experiences, competency or capability within