

## **Toward a 2-Stage Theory of Emerging Market Multinationals**

**Robert Grosse**

Past President & Fellow of Academy of International Business

(AIB)

Thunderbird School of Global Management

Arizona State University, USA

*I present a 2-stage theory in which emerging market firms first compete domestically based on traditional competitive advantages. Once they achieve a threshold stage, then they go overseas and are able to succeed based on company and industry characteristics, as well as emerging market characteristics. I expect to see that factors enabling firms to get to the threshold stage will include: brand value, low-cost production, experience/age, company size, possibly membership in a business group, and international sales (but not technology). Then I would expect that factors enabling firms to succeed internationally should depend on the industrial sector and the target market, as well as demonstrating emerging market idiosyncrasies such as ability to deal with high uncertainty in government policies and economic conditions as well as flexibility in dealing with business conditions. Most analyses of emerging market MNEs focus only on the last set of factors that are common to emerging markets.*

Key Words: emerging market multinationals; emerging markets; competitiveness; global strategy; competitive advantages.

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### **I. Introduction**

A number of authors have written about the successes of emerging market companies in going international and in competing in overseas markets over the past 50 years. The analysis usually jumps from a discussion of conditions in emerging markets that often differ from conditions in Triad countries (for example, greater macroeconomic volatility, more government intervention in markets, lower per capita incomes) right to identifying and explaining the particular competitive advantages that apply to such firms when they expand overseas. As discussed below there are different advantages that apply more to competing in Triad countries (Triad countries include the US and Canada, the European Union, Japan and Australia/New Zealand.) versus

advantages that apply to competing in other emerging markets, particularly in the home region of the company.

There is a missing element to this view, namely identification of the factors that enable the emerging market (EM) company to compete in the first place, in its domestic market. Or in other words, an emerging market company does not succeed in its own domestic market simply by knowing how to compete in an emerging market. That would be true of all of its competitors operating in that same environment. Nothing differentiates one company from another in that sense<sup>1</sup>.

It is extremely unlikely that a company which does not compete well at home will be able to go overseas and compete in other countries. So, there have to be some competitive advantages that get the company on a path toward international competitiveness. These factors can be the same ones that enable traditional MNEs to succeed in their domestic markets: a locally-known brand name, lower costs than competitors, better products than competitors, a desirable location(s), ties to key customers such as large firms or governments. Typically, proprietary technology is not one of these factors, different from the case of Triad-country companies. The reasoning presented here leads to a 2-stage theory of emerging market MNEs, in which they become competitive domestically based on traditional competitive advantages, and then they compete overseas by also taking advantage of some specific emerging market features.

The remainder of the paper discusses some of the literature on domestic competitive advantages of EM companies, as well as literature on international competitive advantages of these firms. Then the two-stage theory is presented in further detail. Applications of the theory to analyzing EM MNEs are considered, followed by some conclusions.

## **II. Literature on Domestic Competitive Advantages of EM Firms**

The literature on competitive advantages of emerging market firms in their domestic markets is relatively limited, in comparison to the literature on such firms' international advantages. Nevertheless, a number of authors have looked at these capabilities. Most of them build on bases such as Porter's (1985) competitive advantages idea, often looking at different stages of the value chain. This is particularly useful, since one major way that EM firms enter international business is by participating in a global value chain as either at the upstream end as a supplier of a raw material (such as oil or an agricultural product) or at the downstream end as a final point of distribution of products/services made in Triad countries (e.g., McDonald's restaurants as franchisees or retail stores selling imported products such as autos or branded clothes or pharmaceuticals) (Elms and Low 2013).

This literature started well before Porter, in the thinking of Joe Bain (1956) about barriers to new competition. Porter's view has been followed by Jay Barney's (1991) idea of company resources such as proprietary technology and other knowledge<sup>2</sup> and Prahalad and Hamel's (1990) idea of core competencies in business activities that distinguish a lead firm from followers. Bain's approach considered capabilities and business conditions that enable a company to build a competitive position based on its differentiated products, scale economies, or its absolute cost advantages. Porter adds importantly to this base by emphasizing the importance of management skills and proprietary technology, and by disaggregating the company's activities into its value chain, and then strategizing to focus on the elements of the value chain where the firm has superior capabilities. Barney and others have added more nuances to the overall logic that to become and remain industry leaders, firms must develop these relative advantages compared to rivals.

This literature on how companies compete using their skills and capabilities is largely based on conditions and examples from Triad countries. There have also been studies of company competitiveness in emerging markets, though they are many fewer in number.

For example, there are a number of studies on Brazil. Fleury (1995) noted that Brazilian firms in the late 20<sup>th</sup> century were able to compete against each other and against foreign multinationals in Brazil by keeping their costs to a minimum and by getting access to government support policies that attempted to protect the market against foreign competition. As the market opened further, domestic firms were forced to focus more on core activities, to contract out less-central activities, and to improve product quality in addition to reducing costs. Akhter and Barcellos (2013) explored Brazilian domestic industrial company strategies also in the context of the economic opening at the end of the 20<sup>th</sup> century and into the 21<sup>st</sup>. They found that to be able to compete in the new environment, these companies had to focus on quality improvement rather than just reducing costs. Even so, costs were very important due to the new competition from Chinese imports. The companies switched their focus significantly in favor of responding to customer needs and paying much greater attention to marketing. Batista et al. (2014) looked at the competitiveness of Brazilian firms in the textile sector in the post-financial crisis era, i.e., after 2010. They found that as the market continued to open to foreign competition, companies succeeded by first getting their costs down and then by differentiating their products by offering superior quality.

There are also several studies of competitive advantages in India. Ramaswamy (2001) looked at Indian companies competing with state-owned enterprises during the process of economic opening, and found that firms in more competitive industries and larger firms performed better on various measures of performance. Kedia et al. (2006) focused on Indian business groups and their competitiveness before and during the economic reform period. Their emphasis was on factors that enabled business groups to survive in the more open, less-regulated environment of the 1990s. They found that business groups that produced more related products and services performed better than those with less-related diversification. And groups that depended less on domestic institutional conditions (esp. working with the government) performed better than firms more tightly tied to government. Vachani (1997) compared the performance of several kinds of firms in India during the liberalization period. He found that large private local companies became more competitive when they were able to take advantage of the opportunity to import into their business activities inputs (including capital) which had been taxed or prohibited earlier. State-owned enterprises were generally hurt by the loss of government protection, while small and medium-sized firms found greater opportunities to expand their businesses – and greater competition with rivals at the same time. Khanna and Palepu (2000, 2006) looked at business groups in India since the economic opening, and they found that large groups demonstrated better performance than independent firms in their same industries.

Mexico has been the subject of quite a few studies of competition among domestic firms. Thomas (2006) looked at 500 firms listed in the business magazine, *Expansion*, and found that firm size was highly significant in his model of firm performance. He also found that international diversification initially caused lower performance for Mexican firms, and then with experience they improved performance with greater international diversification. Grosse and Thomas (2007) looked at a dozen large Mexican business groups, and found that the more diversified firms, across product lines and internationally, had superior performance in comparison with more narrowly-focused companies both during the mid-1990s Tequila crisis and subsequently as Mexico opened its economy aggressively. They also found in interviews at these firms that access to local

distribution channels, superior quality of their products and services, and being part of a business group also appeared to produce better performance. Parnell (2011) found that Mexican companies performed better when they focused on innovation and product differentiation rather than cost minimization.

Peres and Garrido (1998) observed that Latin American large companies tended to compete successfully in domestic markets with some degree of government protection and with their domination of local distribution channels. Since the Latin American firms in their analysis were generally smaller than their MNE competitors from elsewhere, the Latin American firms needed to find offsetting advantages such as superior knowledge of and access to the domestic market in countries including Argentina, Brazil and Mexico.

In the South African context, Mathu (2021) found that small and medium-sized companies demonstrated superior performance when they achieved lower costs through superior supply chain management and when they provided better customer service relative to domestic competitors. Mangaliso (2001) argues that the concept of *ubuntu* (the African belief in a universal bond of sharing that connects all humanity) can provide companies with competitive advantage in South Africa if they use this approach with their customers/clients relative to companies that do not. Grosse, Wocke, and Mthombeni (2021) analyze the South African case, and find several key competitive advantages that explain performance of publicly-traded companies in the domestic market (viz. scale, brand value, experience, dispersed ownership, and previous international exposure).

Performance of companies in the domestic context has also been studied in Vietnam, particularly after that country joined the WTO in 2007. Tuan et al. (2016) found that innovation provided a positive impact on company performance. They discovered specifically that innovations in processes, marketing and organization provided greater competitive advantage than product innovations. Ling et al. (2009) analyzed Vietnamese firms competing with foreign entrants into the country, and found that the Vietnamese companies had strengths in familiarity with the local culture and business practices along with a low-cost labor advantage. Foreign firms coming into Vietnam tended to have better technology and more experience and skill in management of large projects. Vu et al. (2019) found that for 693 listed Vietnamese companies, there was a negative correlation between capital intensity and performance, as well as between firm age and performance, while there was a positive relationship between firm size and performance.

In summary competitive advantages of EM companies in their domestic context have appeared in the literature as shown in Table 1.

**Table 1: Domestic Competitive Advantages of Firms in Emerging Markets**

Domestic Competitive Advantages of Firms in Emerging Markets			
Advantage	Examples		Authors
low-cost production	Gigante (Mx); Brazilian firms		Wells (1983); Peres & Garrido (2007)
	Mexican firms		Grosse & Thomas (2007)
	South African SMEs		Mathu (2021)
	Vietnamese firms		Ling et al. (2009)
brand name	Modelo (Mx); Noel (Col); Nandos (SA);		Grosse et al 2021
	Tata (In); Koc (Tk)		Khanna & Palepu (2000, 2006)
differentiated product	Brazilian textile manufacturers		Batista et al (2016)
	Mexican firms		Parnell (2011)
company size (sales)	Indian firms		Ramaswamy (2001)
	Mexican firms		Thomas (2006)
	Vietnamese firms		Vu et al. (2019)
age	South African firms		Grosse et al 2021
	Vietnamese firms (negative relationship)		Vu et al. (2019)
family-based firm	Mexican firms		Bustani 2016
	Carso (Mx); Luksic (Ch); Cisneros (Ven)		Peres & Garrido (1998)
business group	Indian groups		Khanna & Palepu (2000)
	Mexican groups		Grosse & Thomas (2007)
international sales	South African firms		Grosse et al. 2021

### III. Literature on International Competitive Advantages of EM Firms

In their domestic context, EM firms face the same conditions as rivals, so they presumably would not have or need differential advantages based on being in that emerging market<sup>3</sup>. However, relative to rivals abroad, the emerging market origin could provide advantages to these companies. Broadly speaking, when EM companies compete with Triad MNEs, one would expect them at a minimum to have advantages based on low costs and on existing client relationships from the home country (Wells 1983; Mathews 2006; Guillen and Garcia-Canal, 2009; Contractor 2013).

From the earliest literature on internationally-competitive EM firms, Wells (1983) and Lall (1983) pointed out that these firms tended to have lower costs than Triad-based rivals, and they also often received some kind of government protection either through government ownership or entry barriers to foreign companies or subsidies of one form or another. These are country-specific characteristics. In addition to recognizing these features, Wells (1983) showed that the EM firms did possess ownership, firm-specific advantages ranging from technology to knowledge of emerging markets. He also argued that EM firms tended to transfer ‘appropriate’ technology to other EMs, and they frequently used joint ventures rather than wholly-owned investments

overseas<sup>4</sup>. And Lall (1983) found that EM firms had particular skill at adapting technology to smaller markets and lower-cost environments, as well as at marketing to ethnic groups. He also pointed out that EM firms tended to have superior capabilities for dealing with governments and with political risks in emerging markets.

More recent research in the 2000s proposes a path of development of EM firms that adapt to gaps in their ecosystems and argues that this adaptation makes them very competitive in their home markets (e.g. Chittoor et al 2009; Cuervo-Cazurra and Genc, 2008; Khanna and Palepu, 2006; Williamson et al. 2013). It is argued that EM firms suffer disadvantages due to a lack of resources and skills (e.g. Barnard, 2010; Cuervo-Cazurra and Genc, 2008; Narula 2012). These papers assert that EM firms possess less advanced technology, less managerial and marketing expertise and more limited resources to compete against developed market firms. As a result, they are expected to expand to markets that resemble their home markets with insufficient resources and similar institutional gaps (Kalasin et al., 2014). This reasoning holds fairly well for manufacturing and many service firms, though for natural resource companies, the target overseas markets are often Triad countries, where the EM skills do not apply.

A number of authors pursued the argument that EM MNEs needed a new theory to explain their behavior, because of the differences in comparison with traditional MNEs. Matthews (2006), for example, discussed the characteristics of Asia-based MNEs that he called the Asian Dragons. These firms tended to use joint ventures and other alliances, in addition to FDI, to both exploit their strengths from the home market and also to obtain knowledge and skills from abroad. He focused on the existence of global production networks into which the dragons could fit themselves and build international competitiveness. The firms could enter as assemblers of products made by traditional MNEs and then work their way up the value chain to become original product manufacturers themselves. In his terms, the new MNEs form *linkages* with existing industry leaders (via alliances of various types); they then *leverage* their capabilities through the alliance partners around the world; and finally they *learn* from the partners and through acquisition of companies that possess knowledge and skills that the new MNEs desire. Companies such as Acer, Flextronics, Lenovo and Hon Hai fit this three-part mold particularly well in the ICT industry.

Witt and Lewin (2007) propose the idea of a ‘springboard effect’ through which EM MNEs internationalize by investing overseas to obtain capabilities that they do not have in the domestic market and also to escape constraints that may exist on their expansion in the domestic market. They argue that this springboard concept helps to explain why some EM MNEs such as Lenovo and Haier look overseas to acquire technology or management skills that they can apply both at home and in other countries. They consider the strategies of these firms to aim at reducing or eliminating competitive disadvantages from being late movers and often smaller than existing Triad-based MNEs.

Guillen & Garcia Canals (2009) analyzed what they call ‘new’ MNEs, which are firms that have become multinational in recent years. They contrast these firms with established multinationals such as Exxon, BASF, and Toyota, emphasizing the catch-up needs of the new firms. They include mostly companies from emerging markets, but also new firms from countries such as Spain and other Triad countries if they are recent entrants. These authors point out that the new MNEs often go abroad via acquisitions and alliances to obtain skills and resources that they lack at home, as well as to expand into foreign markets of both advanced and emerging markets. The particular capabilities that they demonstrate include excellence in execution of their strategies, skill for dealing with governments and political risk (particularly in other emerging markets), and flexibility in organizing their operations according to the needs of the situation, rather than via a long-existing, relatively fixed organizational structure as with traditional MNEs.

More recently Ramamurti (2012a,b) asserted that EM MNEs have superior insight into customer needs; ultra-low production costs; frugal innovation; operational excellence in complicated environments; privileged access to resources and markets in the home country; and some first-mover advantages. He goes on to reason that most of the advantages of EM MNEs are the same ones employed by traditional MNEs in similar contexts, and that the emerging market firms are just at an earlier stage of development. (See also Grosse 2016 on this view.)

Contractor (2013) argues that the main competitive advantages that distinguish emerging market MNEs from traditional ones are location-specific capabilities such as a capability for dealing with (intrusive and idiosyncratic) governments, tolerance for ambiguity, and a humility based on the recognized need to catch up with existing leader firms. This last feature tends to allow EM MNEs to be more agile than existing MNEs, and to be willing to accept participation in alliances rather than owning most of the value chain. He also notes that the diaspora of people especially from India and China around the world give firms from those countries access to skills and knowledge in Triad countries and elsewhere that is not as common for traditional MNEs.

Williamson (2015) divided the particular competitive advantages of EM MNEs into three categories. First, successful EM MNEs are innovative in both the traditional sense of industrial R&D (e.g. industry leaders Huawei in telecoms, Embraer in regional jets, and Suzlon in wind energy) and also in process and business model innovation (e.g. Cemex in cement, Tencent in instant messaging, Gerdau in steel). Second, they reconfigure value chains (VCC) to achieve cost savings and superior operation (e.g. the Big 3 Indian business process outsourcing companies taking back-office functions from Triad countries to India, and Chinese mining companies obtaining raw materials by investing in mines in Africa). And third, they use international M&A to obtain skills and knowledge that they lack at home, learning from the foreign partners (e.g. Geely acquiring Volvo to obtain both manufacturing skill and market access, and Mittal steel of India acquiring Arcelor to become the world's largest steel company). He concludes, as do almost all of the analyses, that to understand EM MNEs we need to expand our conception of key competitive advantages beyond the traditional proprietary technology and global brands/marketing skills.

Deng et al. (2020) looked at EMNEs from what they call 'mid-range' emerging markets (though they focus on the BRICS: Brazil, Russia, India, China and South Africa, so they are actually looking at very large emerging markets), and they found that these companies invested overseas to either exploit existing competitive advantages from the home country or explore for competitive advantages in the target market. They argue that the EMNEs may lead with one or the other of these motives from undertaking FDI, and then they complement the first step by pursuing both goals over time. They call this an 'ambidextrous' strategy. This was a sequence followed by a number of South African MNEs, such as Anglo American, SAB Miller, and Old Mutual, that ultimately relisted their shares overseas (typically in London) and relocated their headquarters overseas.

Looking at selected companies from six Latin American countries, Cuervo-Cazurra et al. (2019) found that these firms followed international strategies that emphasized differentiation rather than just low-cost, low-quality products. The eighteen companies in their sample have found ways to establish themselves as product leaders, supply chain orchestrators and even localized technology leaders. Their basic argument is that some Latin American firms have been able to move up the supply chain from being suppliers of commodity inputs such as raw materials or unskilled labor into positions where they produce upstream products and services and/or operate regional distribution channels. These capabilities tend to be based on activity in the home market

that is then extended to other countries, typically still in Latin America. This is quite similar to some of the South African firms that we discuss below, expanding in Africa.

Looking at South African companies, John Luiz and various co-authors argue that these companies may go overseas successfully based on competitive advantages developed at home, such as operating successfully in a weak institutional environment, to reduce the transactions costs as experienced at home. Barnard & Luiz (2018) call this “escape FDI”, following Witt and Lewin (2007). Luiz says that these firms also may go abroad to take advantage of institutional complementarities (i.e., elsewhere in Africa) or institutional substitution further abroad (Luiz et al. 2017; Robertson & Luiz 2019).

Before moving on to the current two-stage view of EM company strategy, it should be noted that another view has been offered by Peng (e.g., 2002, 2008). He presents a conceptual basis of 3 pillars for company strategy, which include both company and industry characteristics, but also institutional characteristics as part of the approach. In this way companies from any country of origin need to select strategies for competing, for example in emerging markets, based on the institutional features of such markets. Thus the ‘institutional voids’ and other features of emerging markets can be incorporated into a conceptual approach for designing EM company strategies that are also based on company strengths and industry characteristics.

#### **IV. Conceptual Structure: A 2-Stage View of Emerging Market Company Competitiveness**

##### **A. Stage 1— Achieving Threshold Capabilities**

How does a company such as FEMSA in Mexico or Nando’s in South Africa or Reliance Industries in India become a multinational? In every case the company grew from a domestic business foundation that eventually spread overseas to foreign markets. FEMSA developed a beer production and distribution powerhouse (Cerveceria Cuauhtémoc Moctezuma) and ancillary business such as bottle production, aluminum production, packaging, and financing. This business spread overseas to nearby countries including the United States. Nando’s built a chain of fast-food restaurants serving its brand of fried chicken and proprietary spices that was eventually expanded overseas around the world, mostly where a South African diaspora exists. And Reliance began as a domestic polyester manufacturing business. They subsequently entered the markets for construction, electric power production, healthcare and financial services. They have expanded through much of the world, and today rank as #155 in the Fortune Global 500.

Each of these companies developed a solid and very competitive business in the domestic market before undertaking any significant expansion overseas. Once they had taken a market-leading position in the domestic market, each company looked at other industries to enter and at other, foreign markets to pursue. This is a classic strategy of successful emerging market companies, if we leave aside state-owned companies such as oil monopolies or telephone companies. And when these successful companies looked overseas at other countries, some new competitive advantages became important, such as the ability to deal with high levels of risk and uncertainty, as well as knowledge about how to sell to lower-income customers. These last advantages were common to companies in the EM home market, but not common for traditional Triad MNEs. So in this second stage, the EM companies are able to benefit from capabilities arising from their experience in the home-country market.

It really should be evident that in a domestic market in order to succeed a company must beat out rivals for the market, whether a restaurant seeking diners or a shirt manufacturer seeking



buyers. The companies that can do this become successful in that domestic context, and they are positioned to take off into further business activities, whether it be different products and services in the domestic market or existing products/services to sell overseas. In other words, they reach a take-off or threshold stage to pursue new opportunities at home and abroad.

Of course, there are exceptions, such as oil and copper companies that serve international markets from the outset, since their raw materials are demanded worldwide, and customers from the largest markets tend to pursue the resources all over the world. And there are likewise services such as tourism in many countries where the primary targets are foreign visitors, as in the Caribbean islands and other beach-driven locations. As well there are ‘born global’ companies that operate typically from the outset through the internet to deal with customers around the world for software and computer-based services. Even with these categories of exception, most of the rest of emerging market businesses are grown at home and only subsequently look overseas, typically for markets<sup>5</sup>.

As discussed in the literature review above, various authors have identified a range of competitive advantages that serve emerging market companies in their domestic markets, as listed in Table 1. These advantages serve the companies in their home countries as they build up competitive positions that ultimately enable them to venture overseas. Noticeable by its absence is *proprietary technology*, which by and large is not a key competitive element for EM firms<sup>6</sup>. There are exceptions, of course, but for the most part these firms are technology followers rather than leaders. Of course, if we consider proprietary knowledge about markets, competitors, customers and suppliers, this kind of ‘technology’ certainly is possessed by EM companies. However, it is not usually included in the standard measures of technology such as R&D intensity or the number of scientists and engineers in the company.

In countries where per capita incomes are on average lower than in the Triad countries, producing products and services at *low cost* is a valuable capability. From selling portions that are smaller than in higher-income countries to using much more (low cost) labor-intensive production processes, EM firms have found that being able to offer low-cost products to people in the local market is a very sustainable competitive advantage. In beauty-conscious Brazil, domestic cosmetics manufacturer Natura has been able to establish a dominant market position with its low-cost, high-quality products relative to both domestic and foreign competitors in the market (Jones 2012).

In many emerging markets, a local agricultural producer will build its market share with low-cost, competitive-quality fruits and vegetables that beat out local rivals due to its achievement of lower costs, often through scale economies of large volumes of production (in the local context). Sometimes these local success stories are bought out by global branded companies such as Chiquita or Del Monte or Kraft Heinz, but often they are able to defend their local market and avoid takeovers.

In any country the possession of a well-known and positive *brand name* conveys a competitive advantage to the company. Whether it is Coca-Cola or Nike in the US context, or Dangote or Nando’s in Africa, a brand name that has been built up over years may give the possessor an advantage over rival companies in the same industry. This is not an advantage that can arise overnight in the way that low-cost production could be set up, or a prime location found

for a restaurant or hotel. It typically takes years to build up a respected brand name. Even so, an existing brand name can be acquired by another company, so this competitive advantage can be bought quickly, although it cannot be created quickly.

Brands in emerging markets are arguably just as important as brands in Triad countries, even though most emerging market brands are unknown to consumers and analysts in the US, Europe, or Japan. Having a strong brand name that implies high-quality products or services is a major competitive advantage in the domestic market from Bolivia to Thailand.

Just as in Triad countries, as a company grows in sales and profits over time, it will develop a stronger position in the market relative to smaller rivals. Once a company achieves a *significant size* relative to rivals, it will typically have a competitive advantage in several areas: in obtaining funding, in visibility with relatively large numbers of employees and probably large and numerous facilities in the country, and in bargaining power relative to suppliers and customers because of the large size. This large size advantage typically builds on other advantages such as low cost or a strong/credible brand name, since those bases enable the firm to become large. But then when large size has been achieved, that characteristic itself enables the firm to gain further benefits from economies of scale, bargaining power and market visibility.

Experience in operating in the market can give a company an edge over newer/younger competitors. The knowledge built up over time about market and supply conditions, regulation, competitors, etc., can enable a company to build a strong competitive position. As a proxy for this idea, *company age* can be seen as a competitive advantage in domestic competition. In addition to specific knowledge, a longer-lived company will have found some way to survive over time, and that resilience or survivability may itself be the source of advantage.

A very interesting phenomenon outside of the United States and the UK are *family-based firms* or business groups. These firms tend to be among the largest in most countries around the world (if we except state-owned oil companies and banks). The question of interest here is about their performance. Do family-based companies have better or worse performance, or rather, do they have competitive advantage relative to non-family-based companies or not? The evidence is not completely clear, although in a few countries such as Mexico (Bustani 2016) and Brazil, family-based firms do demonstrate superior performance – while in other emerging markets such as South Africa (Grosse, Wocke, and Mthombeni 2021) they do not.

*Diversified Business groups* are another category of companies that tend not to do well in the United States (remember Porter's stricture about "stick to your knitting", i.e., to businesses that you know well), but which often thrive in other countries. In the US, conglomerate organization structures have tended not to do well over time, although when interest rates are very low, it is easier to put together portfolios of businesses with debt financing and to keep them going successfully. A 'conglomerate discount' has been observed repeatedly over time in the US stockmarket (e.g. Rajan et al. 2000). In emerging markets, this phenomenon tends not to exist, for various reasons. One key reason is that conglomerate diversification enables the firm to overcome ups and downs in business cycles and industry and regulatory changes. Well-known diversified groups such as Tata Group in India, Dangote in Nigeria, Grupo Luksic in Chile and Grupo Carso in Mexico have performed well relative to rivals in those countries over the years by entering and leaving businesses that rise and fall in profitability over time.

Finally, *international sales* provide a buffer for a company when domestic sales may be unstable. This is a domestic competitive advantage in the sense that companies that have this safety valve for their sales are somewhat shielded from downturns in the domestic market. Thus, they may have more stable earnings than purely domestic competitors.

Once some subset of these competitive advantages is mobilized and enables an emerging market firm to achieve sustainable domestic competitiveness, the firm is poised for international expansion. As noted earlier, this international expansion will be successful based on the firm's domestic competitive advantages plus several additional elements that relate to the origin in an emerging market. This second stage is discussed next.

Before launching into Stage 2, it may be noted that the reason(s) for a company to look abroad rather than staying in the domestic market are quite varied and are not explored here. For example, a firm may set up operations overseas to expand its sales to new markets or its input sources to additional supply locations. The pressure to go overseas may be market-related, or it may be due to constraints in the domestic market, such as Witt and Lewin's 'escape FDI' (2007). These motivations require further investigation in future studies.

## **B. Stage 2 – Taking off into International Competition**

Once they achieve threshold competitiveness in the domestic market, in this second step our analysis is similar to Contractor (2013) and Ramamurti and Williamson (2019), who look at international competitiveness of EM firms.

From the literature and from the author's experience working with EM MNEs, three very clear strengths of these firms can be seen when they compete overseas. These are emerging-market strengths that enable firms to compete successfully against traditional multinationals (1) when risks and uncertainty are higher than in the Triad countries, (2) when local communities play a greater role in the firm's operating success, and (3) when governments are more involved in business. Each of these elements is considered in turn.

A major caveat is important here, since the three advantages mentioned tend to relate to business in other emerging markets. When an emerging market company seeks to expand into a Triad country, very often these three advantages do not serve well, and the firm has to look for other strengths such as ties to existing customers and suppliers in a value chain, or to low costs relative to local competitors. The main focus of the next subsection is on EM firms expanding into other emerging markets using these three competitive advantages. A second subsection then considers EM companies competing in Triad countries. And a final subsection notes some comparisons of the 2-stage theory with other theories related to EM company strategies.

Another caveat is that the paper does not divide the emerging markets into further subcategories such as the least-developed countries (a United Nations category of 46 countries today), or frontier markets (28 more countries that are more developed than that, but still below other categories of emerging markets in terms of per capita incomes). For simplicity we consider the emerging markets to be countries that generally have lower per capita incomes than in Triad countries or OECD countries – although even here there are some exceptions, such as Mexico, Turkey and Chile which are considered to be emerging markets even though they belong to the OECD.

### **1. Managing Risks and Uncertainty**

Features of emerging markets that differ in comparison with industrial countries include the levels of risk and uncertainty in the business environment. Often there are risks (that is, measurable expectations for variation in aggregate demand, prices, exchange rates and other macroeconomic elements of the economy) that are higher than in the US or EU. For example, the inflation and exchange rate variations in many South American countries and sub-Saharan African

countries have been enormous in comparison with dollar inflation and the dollar-euro exchange rate variation over the past decade. Inflation and exchange rate variations have both been higher in emerging markets overall than in industrial countries during the period since World War II, and these have been fairly consistent facts over time.

Beyond the risks of this type, there are uncertainties such as unplanned regime change, capital flight that leads to currency maxi-devaluation, wars, high crime rates, and generally a more unstable environment than in the US-EU countries or Japan. Uncertainty is just defined as the possibility of unexpected outcomes that affect firm profitability/viability that are not measurable. The point here is not to split hairs about the difference between risk and uncertainty, but rather to note that both types of problem are common in emerging markets more than in Triad countries.

Firms originating in emerging markets must deal with these risks and uncertainties from the time they are born, thus their experience in managing these problems is likely to be more extensive than for firms based in industrial countries (Buckley et al. 2007; Contractor 2013). As emerging market companies expand their activities into other emerging markets, this experience is likely to provide a competitive advantage relative to rivals from industrial countries (but not relative to rivals from emerging markets, including the target market) (Guillen and Garcia-Canal 2013).

Looking at the experience of firms from industrial countries, one finds that their overseas expansion tends to be into other industrial countries, with much more limited investment in emerging markets. Even given that many emerging markets have significantly smaller markets than industrial countries, especially the US and EU, this does not explain why industrial country firms have not expanded more extensively into large markets such as China and India, or even Brazil or Mexico, etc. On the other hand, looking at African and Latin American companies, the tendency is clearly to expand nearby, into other African or Latin American countries, before entering in a small number of cases into the US or EU. In short, emerging market firms tend to compete in other emerging markets where uncertainty and risks are high, where the entry costs are low, and where industrial-country firms show less willingness to enter.

## **2. Community Relationship Management**

A second source of competitive advantage for EM firms in international competition is their ability to deal with local communities. For example, the end of the Apartheid regime in 1994 was accompanied by the need to redress the social injustices and disparities in South Africa. Businesses operating in South Africa had to comply with a raft of laws and regulations that range from indigenization policies, such as the Broad-Based Black Economic Empowerment legislation, to the provision of services and infrastructure which government has not been able to provide. Communities in under-developed areas tend to view large companies such as Anglo American as wealthy employers, and consequently tension arises if these companies do not employ locals and when they are viewed as taking profits from the community without adding an adequate benefit to the community.

Similar challenges exist in Latin America with respect to indigenous (Indian) communities. In Mexico and Brazil, as well as in most of the smaller countries of the region, local indigenous communities have been somewhat marginalized over many years. Governments have made repeated efforts to respond to this challenge of inequality, but the challenge still remains. This becomes very difficult for multinational extractive companies to deal with, because their mines or oil wells or other raw materials production typically occurs in areas of concentration of indigenous

people. So copper companies in Peru, for example, resort to extensive community relations efforts to provide local employment, housing, and other services that are inadequately supplied. A major oil pipeline in Ecuador had to be re-routed in several locations, because it would have damaged/destroyed indigenous people's sacred sites and burial grounds, as well as causing ecological harm in the rain forest (Grosse & Yanes 2004).

In Mexico in particular one local business group (Salinas) has put together a large range of products and services aimed at lower and middle-income consumers. This venture has been profitable overall, even though efforts to serve the 'bottom of the pyramid' in emerging markets very often are not financially sustainable. With its consumer-oriented bank (Banco Azteca) offering small loans and other financial services to marginalized communities, its manufacturing division (Italika) producing motorcycles with small-sized engines for low-income consumers, and its retail store network (Elektra) aiming at lower and middle-income consumers, the group has created a viable portfolio of activities that do serve consumers who are usually ignored by major businesses, foreign and domestic. Indigenous people are not the only beneficiaries of this group's products and services, but they are a major portion of those served.

### **3. Dealing with Governments**

A third source of competitive advantage for EM firms in competition with firms from Triad countries is their ability to deal with emerging market governments, starting with their own in the domestic context. This capability comes from necessity, since the government in most emerging markets is much more interventionist than that in the United States or those in the EU.

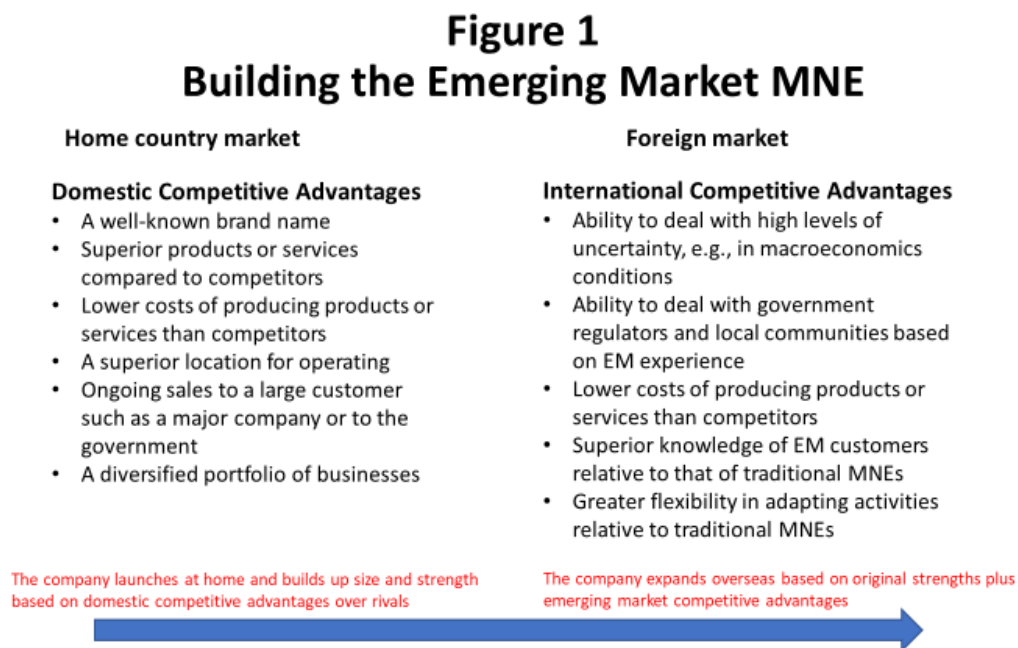
Looking again at South Africa, firms have needed to deal first with a government following the Apartheid policies and then one operating under newly-established full democracy. These very different situations called for very different company strategies of dealing with the government, and thus South African firms were pushed much more than Triad-country firms to respond to changing government interests and demands. Interestingly, since most foreign multinational firms left South Africa during the apartheid years, or had never entered at all, the long-term experience of operating in South Africa really has been limited primarily to local firms. This differs from many other emerging markets such as Brazil, Mexico, and Asian leaders such as India, Malaysia, Thailand, or Indonesia, where foreign firms have had a continuing presence, and thus have had experience dealing with the local government, for many years.

In the Middle East, particularly on the Arabian Peninsula, local companies need to ensure approval of their activities from the government, which is dominated by local sheikhs and their families. This means that local companies that want to grow larger and to be involved in important business, from services to manufacturing, as well as in oil-related businesses, must obtain approval from the ruling sheikhs. This may be a tacit approval to operate, or a requirement that a sheikh's family become involved in the business. In any case the local company must understand the government's point of view of the business, and it must re-evaluate the position over time, as the company grows and possibly as government interests shift.

Dealing with the government successfully in any country can provide a competitive advantage by enabling a firm to obtain licenses or permissions to do business, or contracts to be the supplier to government, or favorable tax treatment, etc. There are many ways in which being able to deal well with a government can provide advantage to a firm; in emerging markets this particular skill has proven extremely valuable in situations where governments change unexpectedly, when governments are pushed to respond to economic, social or political crises, and

just in general when governments seek to demonstrate their concern for society by regulating business. The knowledgeable and prepared company can position itself for favorable treatment in such situations, where the less astute or less-connected firm may not.

Figure 1 depicts the combined, two-stage view of EM company competitiveness, starting from the left side and moving to the right.



#### 4. Competing in Triad Countries

When emerging market companies move into Triad countries, they typically face strong private-sector competitors and less government intervention in the economy. This context requires some different competitive advantages than expansion into other emerging markets. If technology or market knowledge is a key advantage, the EM firm may look to a strategic alliance with a local firm, or to an acquisition of an existing local firm. Grupo Bimbo, one of the largest bread and bakery companies in the world, expanded from its base in Mexico to the United States through the acquisitions of Orowheat, Entenmann's (Weston), and Sara Lee. The Mexican cement company, Cemex, did the same with its acquisition of Rinker Cement in 2007. Indian steelmaker Mittal bought Luxembourg-based steel giant Arcelor as well. The list is very long of emerging market companies building their global businesses through acquisitions of Triad country companies.

An interesting question is: what enables the emerging market company to carry out such acquisitions? And the short answer is: money. Just as with acquisitions in a domestic market among the Triad countries, acquisitions happen all the time, as competitors try to relocate themselves in stronger positions. When an emerging market company attempts to do this, the company likely has a disadvantage relative to local companies in understanding the market there – but the market knowledge is of course built by acquiring the ongoing company. Of course, money does not guarantee success in making an acquisition, but it is a necessary condition that

often stops EM companies from such expansion into Triad countries. Additional capabilities that will enable an EM firm to make a successful acquisition in a Triad country include the ability to assimilate the knowledge gained from the acquired company, management skill needed to operate a company in more than one country, and possible language and cultural elements.

For extractive companies in mining, oil and agricultural products, expansion into Triad countries depends mainly on the availability of the product in question. Why did Sibanye platinum mining company from South Africa expand into the US? Because platinum deposits in Montana were attractive and available at a price that Sibanye felt was viable. Why do several South African mining companies have operations in Australia? Because coal, copper, gold, and uranium are available there. Why does Vale from Brazil have coal mines in Australia? Because large deposits are located in that country, as well as in Brazil.

The number of success stories of emerging market companies expanding into Triad countries is probably much lower than the success stories of expansion into other emerging markets. To some extent this is geographical, since most companies go overseas to markets in their home region. But in addition, the lack of adequate financial resources and knowledge bases definitely limits EM companies in their efforts to enter the US, EU or other Triad countries, where most large MNEs are headquartered.

Overall, the 2-stage theory leads to two research propositions for further study:

Proposition #1: *Emerging market companies compete domestically based on competitive advantages as in other countries.*

Proposition #2: *Once they achieve threshold competitiveness, emerging market service and manufacturing companies compete internationally based on competitive advantages that favor their base in a developing country. And emerging market extractive companies compete internationally based on their ability to obtain access to the raw materials around the world and on their global distribution networks to gain access to customers.*

These two research propositions could be evaluated using empirical evidence from emerging market companies. Of course, exploration of these two propositions remains for future research. Further propositions could be laid out to investigate the strategies for entering other emerging markets versus entering into Triad countries. These contexts are very different, and relatively little has been written about strategies for EM firms to enter other emerging markets. One could even take this issue to another level and look at reasons why emerging market companies expand into other emerging markets that may be at a lower level of development (say, a Least Developed Country in the UN terminology) or a higher level of development (say, any country with higher per capita GDP that is not yet in the Triad category).

### **C. Comparison of the 2-Stage Model with other Emerging Market Company Theories**

The discussion in Section II above talks about domestic competitive advantages of EM firms, and this is not a major source of new theory. That is, most analyses use existing theories such as Porter's competitive advantages or the Resource-Based View to identify factors that enable EM firms to compete successfully at home. And as discussed in that Section, there tends to be somewhat different emphasis on specific factors, where for example a diversified business

portfolio usually leads to better performance, while a technology advantage is much less common in EMs.

The discussion in Section III above on international competitive advantages sketches a number of theories or concepts that can be compared with the 2-stage theory here: Khanna and Palepu's idea of 'institutional voids' that require different capabilities in emerging markets; Mathews' three-part theory of competitiveness of Asian MNEs, based on linkages, leverage, and learning; Luo and Tung's 'springboard effect' through which EM firms gain capabilities not available at home and escape constraints that exist in the home market; and others that focus on specific aspects of EM companies going abroad. The closest theory to the present 2-stage one is the view of Contractor (2013), who argues that the main competitive advantages that distinguish emerging market MNEs from traditional ones are location-specific capabilities such as a capability for dealing with (intrusive and idiosyncratic) governments, tolerance for ambiguity, and a humility based on the recognized need to catch up with existing leader firms.

The two-stage theory is different from these theories because it looks sequentially at competing at home and then competing overseas. This is not necessarily different from the spirit of Dunning's eclectic theory (Dunning 1977, 1988), which also looks at different elements of a firm's ability to compete, although Dunning is mostly interested in international competition. Dunning's theory is much more detailed than the 2-stage theory, in looking at company-specific and country-specific factors as well as the make-versus-buy decision for deciding to own or contract out business activities. In fact, Dunning's view could be applied in each of the two stages of the present theory, with likely different conclusions about how to compete successfully within each context. The fundamental point here is that none of the other theories looks at the two sequential steps of competition, at home and then abroad.<sup>7</sup>

## **V. Conclusions**

The literature on competitive strategies and competitive strengths of companies from emerging markets (EMs) has become quite large (e.g. Ramamurti 2012a; Cuervo-Cazurra 2012; Grosse 2016; Williamson and Wan 2018; Cuervo-Cazurra et al. 2019; Deng et al 2020). One of the major points of debate is whether existing theories of management and international business can explain emerging market companies' strategies and successes, or if new theory is needed to understand this very different context. I take up this issue by proposing a 2-stage theory of competitive strategy for emerging markets firms. Firms that internationalize must first be successful and reach a threshold stage domestically, based on traditional competitive advantages. Once they succeed domestically they are poised for potential international competition. Manufacturing and service firms benefit from several capabilities that differentiate them from traditional Triad MNEs when competing in emerging markets. Mining and other natural resource companies benefit from access to the raw materials and global distribution channels when competing in international markets. This view supplements the large literature on emerging market multinationals, which focuses just on the international aspect of these firms. The 2-stage view does not call for a new theory to understand EM MNEs, but rather it proposes a more detailed look at the process through which they become successful first domestically, and then they enter other countries' markets.



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### **Author's biography**

**Robert Grosse** (PhD, University of North Carolina) is Professor of Business Administration and director for Latin America at Thunderbird School of Global Management, Arizona State University. He is Fellow and past President of the Academy of International Business (AIB). He is also Fellow and past President of the Business association of Latin American Studies. He was the Dean of the School of Business Administration at American University of Sharjah (United Arab Emirates) and Dean of the EGADE Business School at Monterrey Tec in Mexico. He is a leading author in International Business and has extensively published in leading journals. He has consulted or worked for many well-known multinational companies including Standard Bank, Anaconda Copper Corporation, Xerox, American Express, Banco Ganadero, Chase Manhattan Bank, Citibank, EXXON, IBM, Merrill Lynch, Raymond James, Texaco, and YPF.

## Endnotes

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<sup>1</sup> It should still be recognized that even on issues that characterize many emerging markets, such as low-cost labor, ‘institutional voids’, and extensive government participation in the market, any given EM company may develop an advantage relative to other local firms, with lower costs, better management skills, etc.

<sup>2</sup> Barney (1991), Wernerfelt (1984), and others argue that firms can develop superior competitive positions relative to rivals by obtaining and protecting firm-specific resources that are valuable, rare, difficult to imitate and not easy to substitute. This is the VRIO model (as described in Barney and Hesterly 2010). These resources can range from proprietary technology to relationships with key clients to location in a superior geographic place. The resource-based view gives less detailed guidance to the firm about where to look for such resources, and about disaggregating the value chain, but it enables companies and analysts to identify key resources, just as with Porter’s advantages.

<sup>3</sup> Even so, one emerging market company is likely to develop superior capabilities relative to rival companies in dealing with the government, with macroeconomic instability, etc. – so the internationally-relevant advantages also may play an important role in domestic competition as well.

<sup>4</sup> In fact, Wells’ emphasis was on the company-specific factors that enabled EM firms to compete internationally, rather than on location advantages such as low costs or government protection.

<sup>5</sup> There are also some EM companies that look overseas to obtain technology or market knowledge or some other skill or capability by acquiring an existing company there. For example, Geely from China acquired Volvo of Sweden, not because of a desire to serve the Swedish market but rather to obtain a global brand name and technology from the engineers who work at Volvo.

<sup>6</sup> It should be noted that China is no longer an emerging market. It is a world-leading country in technology development, as well as production, exports, and development of multinational companies. China was an emerging market in the 20<sup>th</sup> century, when many examples of Chinese firms appeared in the literature. Since 2001, with Chinese companies producing advanced technology and enormous volumes of production, and with more members of the Fortune Global 500 than any other country today, China should no longer be considered an emerging market, but rather a competing hegemon with the United States for global business and economic leadership.

<sup>7</sup> One could argue that the internationalization process theory of Johanson and Vahlne (1977, 2009) looks at the sequence of steps to expand abroad. This is definitely true, but they do not focus on the competitive advantages that enable a firm to compete in each context.