THE PAST, PRESENT AND FUTURE OF INTERNATIONAL BUSINESS & MANAGEMENT
ADVANCES IN INTERNATIONAL MANAGEMENT

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VOLUME 23

THE PAST, PRESENT AND FUTURE OF INTERNATIONAL BUSINESS & MANAGEMENT

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Timothy is heavily involved in the international networks of scholar. He served as a chair of the International Management Division of the Academy of Management. He is an associate editor of Academy of Management Perspectives and the head of the International Business & Management Network of SSRN. He ran the 2001 Academy of International Business Conference in Sydney. He is on the editorial board of more than 10 of the leading international journals.

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EDITORS’ INTRODUCTION

This is the first volume of Advances in International Management under the new editorial team of Timothy Devinney, Torben Pedersen and Laszlo Tihanyi. We hope to continue the tradition established by our predecessors, Joseph Cheng and Michael Hitt, and also will work to bring a new perspective to the series. It is our intention to use the series less as a journal or book series and more as a forum for ideas and discussion – a view that builds on the tradition of the series but also aims to put it in juxtaposition to traditional publication outlets.

Our first volume hints at a slightly different structure from the past. The first part of volume 23 contains a perspective from Harry Triandis on his life’s work with commentary from two of his students, Chris Earley and Kwok Leung. Professor Triandis was the recipient of the 2009 Booz & Co./strategy + business Eminent Scholar in International Management Award, given by the International Management Division of the Academy of Management.

The second part of volume 23 focuses on the theme of the volume – *The Past, Present and Future of International Business & Management*. This is a critical topic for a field at the crossroads, a fact confirmed by the number of journals that have recently published special retrospective and prospective issues on international business and management. However, unlike these issues, we did not have an open call for manuscripts and then subject them to the traditional journal reviewing process. Instead, we went to three groups of scholars – fellows of the various academies, dissertation competition award winners and best paper prize award winners at the key management and international conferences – with the intent of (a) giving the authors the latitude to be more critical and controversial, subject to our own review and (b) providing an opportunity for a balanced perspective that gave more weight to junior scholars in the field. You can decide whether we were successful at (a). However, when compared with these recent journal special issues, it is clear that we have given considerably more voice to a broader range of scholars both in terms of location, age/experience and perspective.
In closing, we thank Rebecca Forster, Kim Foster and all the Emerald editorial team for their patience and support. In addition, Lacri Nacu provided critical editorial and administrative assistance in completing the volume on time. Without this support the volume would still be in process!

Timothy Devinney
Torben Pedersen
Laszlo Tihanyi
*Editors*
INTRODUCTION TO SECTION 1

BOOZ & CO./STRATEGY + BUSINESS EMINENT SCHOLAR IN INTERNATIONAL MANAGEMENT 2009

Timothy M. Devinney

The Booz & Co./strategy + business Eminent Scholar in International Management is an annual award given by the International Management Division of the Academy of Management and Sponsored by Booz & Co./strategy + business.

The 2009 awardee was Professor Harry Triandis, Emeritus Professor at the University of Illinois. Professor Triandis was recognized for his contribution to the field of international management based upon his longstanding and well-respected work in the field of cross-cultural psychology.

Professor Triandis received his Ph.D. in Social Psychology from Cornell University in 1958 and spent the dominant proportion of his career at the University of Illinois (joining in 1958). Since that time he has authored dozens of books and hundreds of articles and stands as one of the most cited scholars in the field of cross-cultural psychology. His work stands at the base of much of the work linking social psychology and international management, particularly that examining different societal perceptions and attitudes.

He is a fellow of American Association for the Advancement of Science, Divisions 8, 9 and 14 of the American Psychological Association and an Honorary Fellow of the International Association of Cross-Cultural...
Psychology. He has received many prestigious awards, including a Ford Foundation Fellowship, a Guggenheim Fellowship and a Klineberg Award.

In the paper that follows, Professor Triandis outlines aspects of his thinking throughout his life and closes with an overview of his most current work, entitled *Fooling Ourselves: Self-Deception in Politics, Religion, and Terrorism*, which applies his thinking to issues of modern society. In addition, two of the Professor’s former students, Professor Chris Earley and Professor Kwok Leung provide a synopsis of Professor Triandis’s contribution and impact to the fields of social psychology and international management.
FROM CULTURE AND BEHAVIOR TO CULTURE AND SELF-DECEPTION

Harry C. Triandis

For most of my career I studied the relationship between culture and psychological process, and the implication of such relationships for managerial and other behaviors. That has certainly become an important research area. Since I published my *Individualism and Collectivism* book (Triandis, 1995), for instance, this topic has become important in the social sciences. For example, the Kitayama and Cohen’s (2007) *Handbook of Cultural Psychology* has many chapters that use some of that work. I assume that the Academy has honored me for that work.

I continued doing some work in this area, such as a chapter on the history of the study of the relationship between culture and psychology (Triandis, 2007), a chapter on culture theory in the *Handbook of Social Psychological Theories* (Triandis & Gelfand, Forthcoming), and a chapter presenting several hypotheses about factors that link ecology and culture (Triandis, 2009a).

The latter chapter has examined the ecological determinants of three dimensions of cultural variation:

1. Cultural simplicity–complexity (Chick, 1997) that contrasts hunters and gatherers with information societies, but is quite important because it
also reflects the contrast between rural and urban subcultures. It is also related to cognitive simplicity–complexity.

2. Tight vs. loose cultures (Pelto, 1968; Triandis, 1994; Gelfand, Nishii & Raver, 2006) that contrasts cultures that employ many norms and rules and impose them tightly, that is, punish those who deviate from these norms vs. cultures that tolerate deviation. Our own culture started by being very tight. For example, when the first settlers arrived in Virginia in 1607, they required people to attend a Church of England service 14 times per week. Those who did not conform were severely punished, sometimes by death. Since that time, we have been getting looser and looser. According to my own observations we were tighter in the 1950s than now. My studies (Triandis, 2009b) suggest that one of the most important contrasts between Islam and Western cultures is on this dimension. In fact, I included in Triandis (2009b) a theory about terrorism that goes like this: In patriarchal societies the son is likely to rebel against the father. Since Islam is very tight, when the son rebels if he becomes looser he become irreligious, which in that context is socially undesirable. So, when he rebels he becomes tighter, and that is what is characteristic of the Taliban, al-Qaeda, and other extremist groups.

3. Collectivism vs. individualism (Triandis, 1995). In collectivism the self is an aspect of a group – for example, family, tribe, location, religious groups, union, and corporation. In individualism the self is defined as independent of groups. In collectivism the goals of the individual and the group are closely linked, and when they are not identical the goals of the group have precedence over the goals of the individual. In individualism the goals of individuals have priority. In collectivism social behavior is determined by both norms and attitudes. The beta weights of those two independence variables are often equal. In individualism the beta weight for attitudes is usually very large and that of norms is small. In short, in individualism people do what is most enjoyable rather than what is ideal from the point of view of their group. In collectivism even if one dislikes a group one is likely to stay with it. In individualism one is more likely to leave the group. For example, collectivists do not leave jobs they disliked as often as do individualists (Wasti, 2002).

There is some evidence that cultural simplicity, tightness, and collectivism are related to each other, whereas complexity, looseness, and individualism form a cluster of interrelated variables (Carpenter, 2000; Triandis, 1994).

These dimensions operate in different domains, such as the social, economic, political, religious, philosophical, and aesthetic domains. Mao’s
China was collectivist in all these domains, and became individualist in the aesthetic and later the economic domains.

Sometimes I am asked which pole of each of these dimensions is most desirable. I answer none. Ideally, you want people to be moderately collectivist in some domains and moderately individualist in other domains, moderately tight in some and moderately loose in other domains. The “nothing in excess” principle applies to these dimensions. Extreme collectivists who are extremely tight and simple like the Taliban, and extreme individualists who are extremely loose and complex like some people who have trouble “finding themselves” are not characterized by optimal mental health.

In any case, in recent years I deviated from work on culture and psychology. The defining event was the atrocities of September 11, 2001. Soon after that event, I read in the New York Times that Mohammed Atta, the leader of the terrorists, had in his luggage a “Manual for the Raid.” The manual defined the action as “doing God’s work.” That led me to ask: What is the distribution of belief systems, especially religions, across cultures? In many cultures people have strange beliefs. For instance, the Aztecs believed that if they stopped killing their prisoners, the world would come to an end. But to believe that killing 3,000 innocent people is “doing God’s work” was a bit much. So, I read widely, not only in psychology and anthropology, which has a large literature on religion, but also in ancient Greek, Indian, and Chinese philosophy. My conclusion was that humans universally have a tendency to fool themselves. Thus, I wrote: Fooling Ourselves: Self-Deception in Politics, Religion, and Terrorism (2009b).

What is self-deception? One way to think about it is that it is our tendency to use our hopes, needs, and desires to construct the way we see the world. Consider the financial meltdown. Clearly, most of us hoped, needed, and desired to see the price of housing to continue increasing, because that made us richer each and every year. Self-deceptions are fine as long as we do not act according to them. But in this case both the lenders and the borrowers acted according to that self-deception. Of course, other things happened too, but this was an important element that started the meltdown.

We need to know that the way we see the world depends on both what is outside (reality) and what is inside us (our hopes, needs, desires, theories, ideologies, emotions, prejudices, and the like). In some cases, as when we are attacked by a wild animal, 100% of the variance of our perception is controlled by what is outside. In other cases, however, 100% of the variance is controlled by what is inside us. For example, there are people who believe
that Obama is not an American. There is research (Devine, 1989) that shows that most white Americans experience a vague negative emotion when they see the stimulus “black man.” However, most of them control this emotion, so they act in a nonracist way. Neurologist Burton (2008) describes what happens when our reptilian brain emits a negative emotion that is controlled by our cortex. In some cases the emotion controls the perception, so the individual has what he calls a delusional misidentification. Then the individual perceives on the basis of only what is inside that has nothing to do with reality. In most cases the way we see the world depends on both what is outside and inside, but what is inside sometimes controls substantial amounts of variance.

In the book I present numerous examples of self-deception. For example, when the French revolution started, on July 14, 1789 with the storming of the Bastille, Louis XVI wrote in his diary only one word: “Rien.” In other words, nothing happened! Had he avoided this self-deception he might have saved his neck from the guillotine. Philip II (1527–1598) of Spain was a champion self-deceiver. The Encyclopedia Britannica (1957, Vol. 17, p. 722) says of him: “No experience of the failure of his policy could shake his belief in its essential excellence.”

In 1914, the Manifesto of 93 German Intellectuals stated that it is not true that German soldiers trespassed neutral Belgium, it is not true that German soldiers killed Belgian civilians, and it is not true that German soldiers burned the library of the University of Louvain. All three things were true. But how could these intellectual giants that included Nobel Prize winners like Max Planck and Wilhelm Wundt, who started psychology as a laboratory science in 1880, know what their soldiers were doing? Obviously, they did not have direct evidence. They used their hopes, needs, and desires to form their beliefs. In short, even intellectual giants have self-deceptions.

In the book I have examples even from physics! In the last part of the 19th century, after the Germans had discovered the X-rays, a French physicist by the name of Blendot reported that he had discovered the N-rays. Given the French–German rivalry at that time, this was consistent with the hopes, needs, and desires of the French. Thus, he received all kinds of honors, and they tripled his salary. When an American physicist sent a paper to the best French physics journal reporting that he could not replicate Blendot’s work, the journal rejected the paper. That is another aspect of self-deception: We tend to favor positive information and to reject negative information. It turns out that the tendency to prefer positive and neglect negative information is in the genes of some individuals (work by Elaine Fox of the University of Exeter, reported in The Economist, March 2009).
Thus, tendencies toward frequent self-deceptions may have also a genetic component.

Park (2001) presents scores of examples, starting in the 1840s, in which a major invention was announced. The media sometimes proclaimed that it was “the most important discovery of all times.” Often it involved energy, so that “you can have abundant electricity at no cost, forever.” Cold fusion was one of those “breakthroughs” in which both the State of Utah and the Federal Government invested generously. A number of companies, including a subsidiary of Toyota, invested in the development of some of these dreams because their managers did not know or understand the second law of thermodynamics. What could be more consistent with the public’s hopes, needs, and desires than to have cars that are 100% efficient, or perpetual motion?

Bausell (2007) tells that complementary and alternative medicine has been scientifically shown to be ineffective. Nevertheless, the National Institutes of Health have an office of complementary and alternative medicine because a congressman believed in it and insisted that National Institutes of Health must have such an office. He shows that the placebo effect is reliable and accounts for all the findings. In fact, he says: If you suffer from arthritis take glucosamine because that is likely to be helpful even though it is just a placebo! The media, politicians, and the public do not understand statistics, and often rely on evidence obtained with $N = 1$. As long as they like to fool themselves, why not let them do so as long as it does not hurt other people?

In the book I also make the case that many social psychological phenomena, such as ethnocentrism, stereotyping, and the fundamental attribution error, are special cases of self-deception.

Self-deception is often linked to cognitive simplicity. As I looked at my examples throughout the book I found that most of them were cognitively simple. That suggests the hypothesis that simple, tight, and collectivist cultures may provide more examples of self-deception than complex, loose, and individualist cultures. Religiosity is empirically linked to collectivism (Triandis & Singelis, 1998) and is high in Islam and low in Scandinavia, and I suspect that we can find evidence of more cognitively simple self-deceptions in Islam than in Scandinavia. The nonacceptance of Darwin’s theory of evolution can be used as a clue of self-deception. Nonacceptance is about 20% in Scandinavia, 30% in Central Europe, 45% in the United States, 60% in Turkey, and 92% in Egypt (The Economist, October 17, 2009). But this hypothesis needs rigorous testing.

Self-deception is linked also to megalomania. The book provides several examples. For instance, bin Laden thought that the whole world will
become Islamic and he will be the Caliph. In mental hospitals, psychologists found several individuals who believed that they were Christ, God, or that they owned the hospital (Rokeach, 1964).

The correlation of cognitive simplicity and self-deception is testable. One could, for instance, use the method of McConnell, Strain, Brown, and Rydell (2009) to measure the first, and do content analyses that count the statements made by a person that are likely to be consistent with the hopes, needs, and desires of the speaker to measure the second variable.

In any case, in my examples, these two variables are often related. For example, who created the world? The discussion from astrophysics, exobiology, paleontology, evolutionary theory, and so on is too complex. Sagan (1980) used more than 100 pages, and Hawkins and Mlodinow (2005) used a whole book to explain how we moved from the big bang to *Homo sapiens*. It is so much simpler to say: God. God is a wonderful cognitively simple self-deception. It fits our hopes, needs, and desires to have a powerful entity help us win our battles. In most cultures, deities do exactly that, whether the battles are agricultural, industrial, or military. As anthropologist Robert Redfield put it in the Introduction to Malinowski (1954): “Religion is not only people explaining and projecting their dreams; it is not only a sort of spiritual electric – mana – it is not solely to be recognized in social communication – no, religion and magic are ways men must have, being men, to make the world acceptable, manageable, and right” (p. viii). More recent work in anthropology (Atran, 2007) also concludes that the human mind is so constructed that it is natural to look for the causes of events. In short, religion is the natural outcome of the architecture of our minds.

However, in the book I review evidence that people who are religious are healthier and their mental health is better than the health of people who are irreligious. These links have been investigated, and researchers have found some important clues. For example, people who are helpful to other people are happier than people who are not helpful. In one experiment, students were randomly assigned to two groups. In one group the professor instructed them to do nice things for two weeks, such as shopping for groceries for a person who is sick. In the other group they did not receive this instruction. After two weeks their subjective well-being was measured and the experimental group had statistically higher subjective well-being than the control group (Lyubomirsky, Sheldon, & Schkade, 2005). Furthermore, I report that people who behave according to the rituals and traditions of their culture are healthier and happier than people who reject rituals and traditions.
So, in the book I propose that we need to develop a religion that does not include too many self-deceptions, but allows people to use their rituals and traditions. The purpose of life, I argue, is to help as many other people as possible to be healthy (both physically and mentally) and happy, so they can live a long time, but without destroying the environment.

I further suggest that if we are going to make good decisions we should ask ourselves: Could this belief of mine be a self-deception? If it fits our hopes, needs, and desires, we must be suspicious; it probably is a self-deception. In that case, we should not act until we obtain much more information.

Furthermore, we should examine our beliefs to see if they are too simple. For example Goleman (2009) shows that we have the tendency to oversimplify our perceptions of the ecological crisis. For instance, a simple product, such as a shampoo, consists of more than 50 elements and the manufacturing of each has some environmental impact. To compare two shampoos requires a major computation.

Thus, we need to ask: Did we consider all pertinent information? Did we consider contrary information? Did we classify elements that are incompatible into the same category? For instance, the “axis of evil” is a cognitively simple idea. One dictionary definition of axis is that it is “an alliance of nations to coordinate policy.” Since Iran and Iraq are very different, and even fought a war in the 1980s, and North Korea had nothing to do with Iraq, there was no axis, except in the mind of the scriptwriter of George W. Bush.

Did we consider all relevant dimensions? For instance, us vs. them is only one dimension. It is a characteristic of cognitively simple people, to stop thinking about other dimensions of the situation. When a cognitively simple person is hurt, revenge is often the only idea that comes to mind. We should ask: What other dimensions are relevant? Furthermore, are the relationships among the various dimensions complex, such as the more of this, the less of that? If not, again we should try to increase the complexity of our thinking before we take an important decision. Of course, there are complexities in this argument, which I present in the book, but that gives you the general flavor.

When we catch ourselves having cognitively simple self-deceptions, such as that the price of houses will keep increasing forever, we might also ask ourselves if we have other beliefs that have this attribute. For example, is the belief that our GNP will keep increasing forever realistic? The population of the world is increasing, and the resources of the world are more or less finite.
Can the earth provide a high standard of living for the 9 billion people that will be around in the year 2050?

In the book I also argue that we can judge cultures according to four criteria:

1. Do they give their population a lifestyle that is healthy (both physically and mentally)?
2. Do people live for a long time?
3. Are the people happy?
4. Do the people behave in an environmentally responsible way?

As I look around I see very few cultures that meet these four criteria. Our own culture is doing only moderately well on these criteria. On health we are 37th. For instance, we are not doing as well on objective indices, such as heart attack and cancer rates per 100,000, depression rates, and the like, as does Britain (Journal of the American Medical Association, 2006). On subjective well-being we are 13th in the world (Tov & Diener, 2007, p. 693). On longevity we are 42nd in the world (Andorra is No. 1). We are the most polluting culture after China. Until recently, we were No. 1 on this shameful criterion!

In short, I suggest that having too many cognitively simple self-deceptions is often not good for us. But on the other hand, research shows that it is all right to have them sometime. For example, Shelley Taylor (1989) has found that cancer patients, or people who have AIDS, who think that they are going to live a normal life do in fact live longer than those who do not believe that. Those who are realistic about their marriage are not as happy as those who think that their spouse is perfect (Seligman, 2002). In short, positive illusions are sometimes good for our mental health.

Research on the relationship between culture and the frequency of self-deceptions should prove useful. If we discover relationships between cultural variables and self-deception, we will be able to anticipate when we meet a person from another culture that perhaps that person is especially susceptible to cognitively simple self-deceptions. In cross-cultural training also it is desirable to take this variable into account. Training people to identify their cognitively simple self-deceptions may make negotiations easier, and may result in a better adjustment of people from one culture when they migrate to another culture.

Let us face it: The world is complex, but it is our hope, need, and desire that it be simple.
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CULTURE, PSYCHOLOGY, MANAGEMENT, AND HARRY TRIANDIS

P. Christopher Earley

ABSTRACT

The focus of this paper is to provide an overview and conceptual summary of various contributions made by Professor Harry Triandis of the University of Illinois, Urbana-Champaign. Known throughout the world as a preeminent scholar in the field of cross-cultural psychology, Triandis has achieved the status of a founding father in this field extending his work into related disciplines including management and business, sociology, political science just to name a few. I address these contributions through the rhetoric of five questions, namely, how has his work—(1) shaped a field (self in context), (2) integrated a field (analysis of subjective culture), (3) extended a field (INDCOL), (4) populated a field (students and colleagues), and (5) ensured the future of a field.

INTRODUCTION

There is much profit from seeing new lands and new houses, in seeing beautiful gardens and fields, in seeing different faces and coming across different languages and colors, and...
There are many scholars who have contributed to the field of cross-cultural psychology but few who have had the influence of Harry Triandis. In this paper, I will use five basic questions to address the relative contributions of Professor Harry Triandis from the University of Illinois, Urbana-Champaign. While this may appear to be a tribute or biography, the purpose of my paper is to look at various ways that this individual has shaped the field of cross-cultural psychology and related disciplines through his impact on his own research, his impact on other researchers, and work stemming from his students (creating an emphasis on the self in context; providing for an integration of multilevel constructs; extending existing research emphases; and providing momentum for the future). I will summarize my views on these various influences in the remainder of this paper.

**HOW HAS TRIANDIS SHAPED THE FIELD OF CULTURAL STUDIES? SELF IN CONTEXT**

An immediate and obvious influence of Triandis on the field of cultural studies is evidenced by his impact on the research of other scholars. As an example, his citation count is well over 20,000 and he has published hundreds of articles and chapters, numerous books, countless presentations, etc.

Arguably, the most important impact of his work is situating the self-concept into a cultural milieu through sociological, psychological, and anthropological mechanisms. Much of Triandis’s work has been focused on defining the self in a social-cultural context such as his work on individualism–collectivism or tight versus loose cultures and, more recently, his attention has turned toward the topic of self-deception and its relationship to significant political and social events such as terrorism and religious disharmony.

Triandis focused on three types of self-concept, or selves, in his landmark paper in *Psychological Review* (Triandis, 1989). In his paper, Triandis draws from work by Baumeister (1986) who distinguishes among three types of selves – private, public, and collective (community). The private self captures an internal examination of self-concept in reference to personal
traits, characteristics, behavior, etc. whereas the public self refers to the self using generalized others and the collective self refers to using a specific reference group, or in-group, in an assessment of the self. He argued that the likelihood of sampling a particular self is related to cultural background, such that, for example, in families in which a child is urged to act independently, the private self is likely to be accessed when the child faces new challenges.

At the core of these various approaches is the construct of self and how it relates to social and cultural settings. While I won’t dwell on this topic further in this section, I will note how this theme permeates a number of other aspects of his work in the sections that follow.

**HOW HAS TRIANDIS INTEGRATED A FIELD? GRAND LEVEL THEORY**

Triandis (1972) presented a very significant cross-level approach to culture in his book, *The Analysis of Subjective Culture*, which is notable for its breadth in linking physical and social environments, individual values, and psychological processes. This model addresses how people in different cultures perceive their social environment and how environmental factors influence these processes. In Triandis’s model, the distal antecedent of subjective culture is the physical environment, which includes resources and historical events. The physical environment has a direct impact on a society’s economic activities, which, in turn, influence more proximate antecedents, such as occupations and labor structure. Historical events have an impact on the social and political organizations that evolve in a society and on more proximal aspects of culture, including language, religion, location, and feedback from own behavior. The impact of basic psychological processes such as learning (cognitive and instrumental), categorization, and conditioning on subjective culture is illustrated through a variety of more specific sociological and psychological constructs including roles, tasks, norms, cognitive structures, values, affect, behavioral intentions, habits, and utilities. The determinants of action in Triandis’s model are an individual’s behavioral intentions, which are influenced by subjective culture. It is the relation between subjective culture and behavioral intentions that provides the explicit link lacking in many other models. In a subjective culture approach, values influence behavioral intentions through an individual’s affective states and cognitive structures.
(though values are reciprocally determined by cognitive structures). Triandis adds nonvolitional antecedents of action not typically incorporated in others’ models. Habits, he argues, represent the impact of repeated feedback concerning actions. For example, linguistic cues may convey status within a culture and such cues are often enacted habitually. Social behaviors such as acceptable social distances for interaction represent another example of such habits and these more subtle behavioral cues often have a very significant impact on social interactions across cultures.

While this model was not the first “grand” theory linking macro and distal influences to action, it was significant and important in that it provided for levels of causal specificity not often seen at the time. Additionally, Triandis himself (1972) suggested that his model did not fully delineate the subprocesses and detailed variables that one might draw upon to explain action, but his framework set an agenda for the field to develop specific midrange models and frameworks to address this limitation of his grand theory.

In my view, this framework of Triandis’s is perhaps his most important work in that he provided a backdrop for individuals to study culture and action. For any serious scholar of cultural studies, this framework is essential reading and it provides a tangible but comprehensive approach for both conceptual as well as empirical scholars.

HOW HAS TRIANDIS EXTENDED A FIELD?

INDIVIDUALISM–COLLECTIVISM
AND SELF-DECEPTION

Triandis is probably best known for his work on the cultural trait of individualism–collectivism culminating with his 1995 book with a similar name along with a landmark conceptual piece in 1989 published in *Psychological Review*. This paper in *Psychological Review* foreshadowed the seminal piece by Markus and Kitayama (1991, *Psychological Bulletin*) looking at self-concepts in relation to individuals and groups. Scholars have long attempted to understand variations in cultural practices and structures through a careful assessment of differing values across societies. What seems to be relatively universal in these approaches is the identification of how an individual views himself or herself in the context of others.

A dimension used to capture this concept of self is individualism and collectivism, or an individual’s perceptions and attitudes toward himself or
herself and others in social relationships (Kluckhohn & Strodtbeck, 1961; Triandis, 1989, 1995; Hofstede, 1980, 1991). In an individualistic culture, people look to their own actions to understand who they are, and these actions are relatively independent of others. In a collectivistic culture, people base their self-understanding on the reactions of important others around them. A worker from an individualistic culture strives to improve work performance because of the recognition he or she may receive, whereas a worker from a collectivistic culture seeks improvement because of the gains his or her group may receive (Wagner & Moch, 1986; Erez & Earley, 1993). Thus, people’s self-concepts are regulated, in part, by their cultural orientation and values (Rokeach, 1973).

Memory structures, knowledge, and experiences stored schematically are not solely accessed through a single self; rather, people more easily incorporate information that is provided when it is consistent with their culturally dominant self. As Triandis (1989) suggested, whether they are individualists or collectivists, people sample from three selves (private, public, and collective), with the amounts varying by cultural background. This implies that individualists provided with group-focused training or collectivists provided with individual-focused training do not ignore the information they receive; they use it to different degrees in assessing their self-efficacy, provided that it is relevant to a given task. While training consistent with a person’s cultural background will be more effective than inconsistent training, training that is inconsistent will still be sampled, and it will provide some benefits. Indirect support for this point is evident in the training literature, which has shown that people respond to both individual- and group-based methods.

Triandis (1989) explicitly distinguished between the societal and the individual level of analysis. At the individual level, he described the counterparts of individualism and collectivism as idiocentrism and allocentrism, respectively. He argued that within any society, people vary in their beliefs about a cultural dimension, so that a member of a collectivistic culture may endorse individualistic values and beliefs. In my studies (e.g., Earley, 1989), the differences between the cultural and individual levels were neither consistent nor strong, suggesting that the dual assessment of individualism–collectivism tapped parallel constructs. While the individual-level assessment appeared to have the strongest relationship to self-efficacy and performance, this may simply reflect its proximity to the dependent variables (same level of analysis and measurement).

More recently, Triandis has turned to the construct of self-deception (see Triandis’s paper in this volume for more detail) as a means of addressing
both cultural and humanistic views of global living. With the struggles faced globally around issues of terrorism, economic crisis, and environmental disasters, Triandis has argued that self-deception is a construct having central importance.

**HOW HAS TRIANDIS POPULATED A FIELD? A SAMPLING OF STUDENTS AND SCHOLARS INFLUENCED BY TRIANDIS**

Let me preface this section by apologizing in advance for the numerous people I have not included in these various listings – my intention is not to slight these individuals, rather my purpose is to show a sampling of the span of influence that Triandis has had on scholars in the field.

I begin with what I might term the “Old Folks” such as Adamopolous, Vassiliou, and Hui. I might note that Harry Hui and I were contemporaries at Illinois in our doctoral program, so I’m afraid this tips my hat as to what category I might well fall under despite my own self-deceptions concerning age and vigor. Hui is one of the strongest exemplars of Triandis’s influence – not one of unidirectionality but one of reciprocal determinism. Triandis has often commented that Hui helped stimulate his interest ultimately in individualism–collectivism, and this formed the topic of Hui’s thesis in graduate school. This is a pattern for a scholar such as Triandis, namely, that he nurtures within his graduate students their primordial interests guiding them toward substantive contributions. But Hui’s work was a starting point that stimulated Triandis’s interest in a topic that would take him on a quarter century of work.

The next group of students were a “Gen X” group including people such as Bhagat, Bontempo, Bhawuk, Gelfand, and Kashima (and the next generation with individuals such as Vijayan Munusamy). Even recently, Triandis has been working with Gelfand on an edited volume focusing on cultural psychological theories.

But there have been many “collateral influences” as well. These are individuals who were not traditional “Triandis students” but whose research, thinking, and teaching have been profoundly impacted by Triandis as a person, scholar, and author. These individuals include people such as Erez, Leung, Earley, Boyacigiller, Chao Chen, and Yaru Chen. In my own case, the first cross-cultural psychology class I took was from Triandis at Illinois during my doctoral training. This influence is seen in other collateral
fashions such as the influence of Triandis on the thinking and scholarship of other leaders in the field such as Hazel Markus, Jeanne Brett, Joel Brockner, Richard Nisbett, and Michael Morris.

I would be remiss if I didn’t add a very personal anecdote as a sign of my immense respect and appreciation for Harry in my own career (although I alone am responsible for the shortcomings and limitations). A number of years ago at an international conference, Harry attended a presentation I had made about the work I was beginning on the topic of *Cultural Intelligence*. After the symposium had ended and people were walking out of the session, Harry approached me and simply said, “we’re proud of you.” To this day, I’m most proud of this praise and I would gladly give away published papers, books, awards, etc. to retain this comment. But what is more remarkable is that a scholar of Triandis’s stature would still feel compelled to provide a reinforcing comment to a former student from his university. Triandis has show similar grace and class in dealing with others in the field. It’s my view that his personal style and kindness transcends his papers, books, theories, and plethora of presentations.

## HOW HAS TRIANDIS ENSURED THE FUTURE OF THE FIELD?

If I’ve accomplished my goal in this paper, then the reader doesn’t require an answer to this final question. Through the pioneering of a field, development of grand theory, elaboration of a key cultural construct, and the development of other scholars, Triandis has left a legacy and mark that will not be soon forgotten. Even more remarkable, is that Triandis continues with the curiosity and scholarly emphasis as a senior statesman of the field just as he showed during his early period at Illinois as an emerging scholar.

As an academic turned Dean (and, egads, referred to as an *administrator* by my Provost), I have tried to instill the sense of scholarship and contribution to my faculty that I was taught by Triandis and my other mentors at Illinois including Erez, Lind, Laughlin, Hulin, and McGrath, to name but a few. While I appreciate the prolific nature of Triandis over his career, it’s his impact and thoughtfulness that will be remembered across generations of cultural scholars. His framework of person-in-society, cultural values work, and attitudes research stand out among his many other contributions. And as an individual, I’m proud to have been taught and guided by, as well as interacted with, Harry Triandis.
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SELF-DECEPTION AND THE IDEAL CULTURE: IMPLICATIONS FOR INTERNATIONAL MANAGEMENT RESEARCH

Kwok Leung

In a distinguished career spanning across six decades, Harry Triandis has brought culture to the front and center in psychology and management. His work on subjective culture and cultural dimensions, especially individualism–collectivism, is trail-blazing and has inspired hundreds of studies. I had the good fortune of having Harry Triandis as the supervisor of my doctoral dissertation. His wise counsel and penetrating insight helped me understand what rigorous and relevant research is all about, and laid the foundation for my subsequent scholarly work.

Triandis has retired for over 10 years, but he remains as intellectually active as ever, setting an excellent role model for those of us who begin to contemplate about life after retirement. He published a book on self-deception in 2009, upon which his paper for the 2009 Eminent Scholar in International Management Award is based. I am struck by the many new ideas that he presents in this paper. As I will explain later, some of the ideas are so “outside of the box” and fervent that they may change the course of international management research. I am much honored to have this opportunity to comment on these ideas.
SHOULD WE EVALUATE A CULTURE?

In comparative research across cultures, there is an implicit norm against the evaluation of cultures. Researchers, especially from outside of a culture, tend to restrain from describing the studied culture in negative terms, such as “primitive,” “ineffective,” and “immoral.” This nonjudgmental stance springs partly from the need to be objective and partly from the avoidance of neocolonialist and imperialist impressions.

In a globalizing world in which firms compete against each other fiercely across national boundaries, cultural relativism may be a disguise for ducking the hard question of why some cultures fare poorly in the competition. Individuals, firms, and nations need sound advice to ramp up their competitiveness, and such advice has to be prescriptive. While social science research does not gear toward generating prescriptive knowledge, there is no reason why this must be the case. In a review of the personality change among the Chinese people, Yang (1986) argues that a culture has to adapt to its ecological environment. Cultural elements that are less functional in a given time period will fade away, whereas cultural elements that are adaptive will be reinforced (for similar arguments, see Berry, 1976; Triandis, 1972). To illustrate this argument, consider corruption control and law and order, which are essential elements of good governance (Drori, Jang, & Meyer, 2006). A culture must eradicate corruption and uphold law and order if it desires the benefits of good governance. A more obvious example comes from the auto industry. American auto firms have been losing ground to Japanese and German auto firms. The requirements for making a high-quality car do not vary across cultures, and if American auto firms want to survive, they need to emulate the best practices of their Japanese and German counterparts. In a nutshell, cultures are under pressure to be adaptive and need to phase out elements that are counterproductive. The ecological perspective provides some objective ground for judging whether a cultural element is functional or not. This line of reasoning suggests that a key contribution of cross-cultural research is to provide prescriptive knowledge for the continued success of a culture.

When asked about the desirability of individualism and collectivism, Triandis does not shy away from prescriptive advice and proposes the “nothing in excess” principle, which echoes the Golden Mean of Aristotle and the Doctrine of the Mean (zhongyong) in Confucianism. In an era of dwindling natural resources, the wisdom of moderation in the materialistic domain is self-evident. What is less obvious is the benefit of moderation in
cultural functioning, which awaits verification and refinement in future research. The key point to note here is that a prescriptive answer is provided to the question of what works best for a culture, a question rarely raised in our research.

SELF-DECEPTION AND THE IDEAL CULTURE

While psychologists from Freud to contemporary cognitive psychologists see self-deception as widespread, Triandis is also concerned with the collective self-deception of a culture. To detect self-deception, he proposes that if a belief fits the hopes, needs, and desires of a person or a group, self-deception is likely to be operative and the belief must be scrutinized vigilantly. Unfortunately, this sage advice is often ignored, exactly because of the influence of collective self-deception. Some recent tragedies brewed by unchecked self-deception include the collapse of AIG, the burst of the housing bubble in the United States, and the banking crisis in Iceland.

To avoid the grim consequences of collective self-deception, Triandis proposes four criteria to evaluate a cultural group:

1. physical and mental health,
2. life expectancy,
3. happiness,
4. environmental protection.

I note that these four criteria are related to wealth. Wealthier nations are healthier and have a longer life expectancy because they are more resourceful. In addition, Diener, Sandvik, Seidlitz, and Diener (1993) found that wealth is positively related to subjective well-being within and across nations, especially for individuals with lower income levels. Unfortunately, the blissful life in wealthy nations comes at the expense of the environment, as all the top polluters on a per capita basis are wealthy nations. People in wealthy nations consume more in order to stay healthy, live long, and be happy. I see a fundamental conflict between materialistic well-being and environmental protection, and a case in point is that global warming is primarily caused by the materialistic pursuit of wealthy nations since the Second World War. The economic rise of the large developing countries, including Brazil, Russia, India, and China, will further worsen the already calamitous straits the world is in.

A relativistic approach could be taken to compare nations in environmental projection by controlling for wealth, invoking such measures as
expenditure on pollution control as percentage of GDP and energy efficiency (amount of pollutants per unit GDP). However, this approach will be slow in curbing the pollutants plaguing the world. There is no escape from the fundamental challenge of how to reduce pollution drastically, especially when Triandis reminds us of the population explosion in the next several decades. The key solution is to balance the pursuit of wealth, and hence better health, longer lives, and more happiness and the supremacy of protecting the environment. No such solution is around the corner, as both poor and wealthy nations are wary of, if not dead set against, giving up their self-interest for the common good. Wealthy nations are unwilling to sacrifice their materialistic comfort and offer significant help to developing nations to reduce pollution. Developing nations hesitate to sacrifice their economic growth to prevent future ecological catastrophes. The cultures in the world are far away from the ideal as defined by the four criteria of Triandis.

IMPLICATIONS FOR INTERNATIONAL MANAGEMENT

Triandis has raised some profound, soul-searching questions about how to safeguard against follies that will render our lives and the lives of future generations miserable. After over six decades of acclaimed scholarship, Triandis is of course well-positioned to provide the broad field of social science with seminal, provocative insight for reflection, debate, and research. I discern at least three major implications of the ideas in this paper for international management research.

Relevance

Like other social science disciplines, international management scholars hesitate to evaluate different cultural groups explicitly in terms of their management effectiveness. Of course, practitioners such as management consultants are not shy about telling their clients what good management practices are, and “benchmarking” is a buzzword in corporate parlance across the globe. The analysis of Triandis points to the need to provide prescriptive answers to burning questions in international management research. A few such questions come to my mind. Should Western firms seriously learn from the lean manufacturing system of Toyota, even if they
are from nonmanufacturing sectors, such as health care (McCarthy, 2006)? Should the compensation of European CEOs be raised to the level of that of American CEOs to bring out their best performance? East Asians have a tendency to avoid conflict (Leung, 1997), and should they be encouraged to bring conflict into the open to improve organizational effectiveness? Should Indian IT firms wholeheartedly emulate Accenture and IBM if they want to be world-class? Large business groups are more common in East Asia than in the West (Chang, 2006), but do they represent a suboptimal organizational form? Should Asian firms lay off employees to the same extent as American firms to maintain their profitability?

It is widely recognized that there is a disconnect between management research and management concerns in the real world (Gulati, 2007), because management research is mostly theory-driven, not problem- or phenomenon-driven. This is also why most “how to” books are written by management practitioners, and not by academics. The search for prescriptive knowledge in the realm of international management will make our discipline more relevant and meaningful in the eyes of managers and other stakeholders in society.

**Purpose of a Firm**

The fundamental purpose of a firm is widely believed to be the maximization of its return to shareholders. This view has been tainted by the recent financial crisis, and corporate social responsibilities are now in the limelight. The four criteria proposed by Triandis to evaluate cultures can easily be adapted to evaluate firms. A firm that pays well is not good enough; it should also promote the health and life expectancy of employees, care about their well-being, and protect the environment. Unfortunately, the tension between profit maximization and these other noble motives is even more ferocious at the firm level than at the culture level. Take health as an example. Firms impose an incessant demand for higher productivity on their employees, and it is easy to find global firms that pay only lip service to employee well-being (Radin & Calkins, 2006). The irony is that when firms are not doing well, people fare better in their health. Recession is related to fewer health problems and a lower death rate in the United States (Ruhm, 2000). A recent article in *Fortune* reports that a major manufacturer of caskets in the United States sees its profit dropping because of a lower death rate associated with the current recession (Colvin, 2009).
The analysis of Triandis calls for a broad set of metrics to evaluate firm performance. In the realm of international management, at least one more criterion is necessary. Multinationals as a rule are from advanced countries, and they operate in many developing countries. In evaluating the success of a multinational, how it fulfills its social responsibilities should be taken into account (Husted & Allen, 2006). Just providing jobs to locals is not sufficient; multinational firms should contribute to the well-being of the host community in the broad areas outlined by Triandis.

_Self-Deception in the International Management Context_

Triandis (2009) argues that self-deception is widespread because humans have the tendency to use their hopes, needs, and desires to construct the way they see the world. The topic of self-deception has not received much attention in international management research. We know that entrepreneurs are frequent victims of self-deception in risk assessment as they tend to be overconfident and commit judgmental errors (Busenitz & Barney, 1997). Internationalization of a firm involves entrepreneurial activities and risk assessment (Shrader, Oviatt, & McDougall, 2000), and the “hopes, needs, and desires” associated with the motive to internationalize are likely to fuel extensive self-deception.

Many interesting research questions can be raised from the self-deception perspective. For instance, as a result of the recent financial crisis, the British government intends to levy a significant tax on the bonuses that financial institutions pay to their employees, and some foreign firms, such as Goldman Sachs, are considering the withdrawal from Britain. It is an interesting question to find out if self-deception is involved in this event. Can a government regulate the large bonuses that financial institutions pay to their employees in this global era, in which a business can be run from a distance? Can a financial firm set up its compensation scheme in any way it wants because of the flexibility provided by globalization? Another example is concerned with the ambition of non-Western firms to be a global player. Most Asian multinationals come from Japan and Korea, but China is also pushing ahead to globalize its firms (Li, 2007). Very few successful multinationals are from developing countries, and the question can be raised with regard to the extent to which Chinese firms will become victims of self-deception and overestimate their chance of success because of their desire to be globally present.
THE ROAD AHEAD

The new millennium has marked the beginning of a new era for the human race as well as for multinationals. In this century, environmental threats coupled with population explosion will force billions of people into meager existence, creating hostile and volatile social milieux for multinationals to grapple with. The depletion of petroleum will fundamentally change the structures and operations of businesses and societies. The rise of Brazil, Russia, India, and China will create a drastically different, much more complex, and dynamic world order. These changes are imminent, and international management researchers cannot assume a business-as-usual attitude and continue to do what we have been doing. Triandis has provided some frame-breaking ideas about how culture should be studied and assessed. For international management scholars who understand that humanity may face a major tipping point, his ideas are a potent source of inspiration and creativity for formulating research to address the most pressing issues in this new era.

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SECTION 2
INTRODUCTION TO SECTION 2

THE PAST, PRESENT AND FUTURE OF INTERNATIONAL BUSINESS & MANAGEMENT

Timothy M. Devinney, Torben Pedersen and Laszlo Tihanyi

INTERNATIONAL BUSINESS AND MANAGEMENT AT THE CROSSROADS

International business (IB) and international management (IM) are at a crossroads of sorts. The question is whether the roads emanating from this crossroad lead to somewhere or to nowhere and whether all roads lead to the same place.

If we examine the facts that lead us to this conclusion they do not, by and large, provide any guidance as to where the roads lead. For example, there are some strong signals that IB/IM is in decline. The number of distinctive IB/IM departments and degree programs has fallen with many noted universities having merged previously independent IB/IM groups into areas such as business strategy or management. Although one of the larger divisions in the Academy of Management, the International Management Division has reached a plateau in terms of its membership, while more ‘topical’ divisions such as Business Policy and Strategy, Entrepreneurship and Social Issues in Management have continued to grow.
However, at the same time, the degree to which IB/IM theories and constructs have filtered into established areas of management research has been quite spectacular; hinting that IB/IM has changed and adapted and led to adaptation by other fields. Barely 20 years ago it was the infrequent article in leading non-IB/IM journals that made reference to multinational corporations (MNCs) or issues that fell within the bailiwick of IB/IM. Many leading scholars now identify themselves as interested in IB/IM topics to some degree. The very obvious recognition of this phenomenon is the establishment of the *Global Strategy Journal* as an analog to the *Strategic Management Journal*, although one can point to an increasing number of articles addressing IB/IM issues or applying international thinking to new markets.

Hence, we can view the crossroads we are facing in two ways. From a more negative perspective, IB/IM as a distinctive field is declining. It is becoming harder and harder to find a scholar under the age of 50 who view him/herself as exclusively, or even predominantly, interested in IB/IM alone. It is also harder to find students majoring in IB/IM degrees or universities and business schools that are willing to justify a distinctive IB/IM group. More positively, IB/IM scholars can take heart in the fact that many basic precepts in IB/IM research are now well ensconced in other fields and the necessity of seeking broad international domains for studying management and business problems is becoming de rigueur. From this perspective, IB/IM thinking has morphed both our colleagues and us into polygamous and ambidextrous scholars.

So what we have is a question of whether IB/IM’s intellectual glass is half-empty or half-full and if it in the process of being emptied or filled. From our perspective, this is a question that can only be answered by making a choice going forward; a choice that involves the questions of: (1) what we choose to study, (2) why we choose to study it, (3) how we choose to study it and (4) to whom do we wish to communicate what it is that we are studying and the conclusions that follow from our work.

Traditionally, the focus on much of IB/IM research has been on the distinctiveness of the domain of the phenomena under investigation. For example, the historic contributions of many leading IB/IM scholars were based on: (a) a phenomenon excluded from study in another field (e.g., the failure to account for the MNC in trade theory) or (b) the distinctiveness of the application of a specific theory to a specific international phenomenon (e.g., the application of transaction cost theory to internationalization). Similarly, leading IB/IM scholars established legitimacy by: (a) arguing for the uniqueness of IM operations (e.g., the global integration-local
responsiveness matrix) or (b) the necessity of accounting for the greater heterogeneity in resources and markets (e.g., liability or foreignness and cultural distance). This is not to say that there was not more behind IB/IM scholarship but that for many both inside and outside the field it was the ‘international’ and ‘foreign’ domain versus the ‘national’ or ‘local’ domain that justified the distinctiveness of IB/IM as an intellectually separate field.

However, what is equally clear is that IB/IM did not arise as a separate science, nor has it, with time, distanced itself from its parent disciplines. For example, a comparison with work in finance is illuminating. Modern finance theory that grew up in the post Modigliani–Miller period was a distinctly different mode of science from the pseudo-scientific chartist-based finance research that operated prior to this period. Indeed, from a Kuhnian perspective, Modigliani–Miller and the economics and econometrics-based scholarship that arised in the 1960s, was a distinct paradigm shift that completely excluded the ‘old’ mode of thinking. For IB/IM we see no such shift. If anything, the fields from which IB/IM arose are as relevant today as they were 60 years ago. We are, whether we like it or not, an appendage of economics, psychology, sociology and other management disciplines.

This need not be an factor implying that IB/IM occupies a secondary rung in the food chain of management science but it does say much about the nature of IB/IM research. Although research in finance has taken on a distinctiveness that makes finance scholarship different from that in economics and econometrics, IB/IM research is still distinctly aligned with paradigms in economics, psychology, sociology and our related disciplines. We are distinct only in the domain, not the method or logic of our science. The implications of this are worth outlining.

If we go back to our four questions – to whom, what, why and how – we can see that the issues facing IB/IM going forward are both complex and exciting. If we only seek to inform other IB/IM scholars about IB/IM-related phenomena or theories, we can see that the roads emanating from the crossroads will probably lead us nowhere. But we would argue that the hallmark of our work is that this is precisely not what we seek to do. Our linkages to the primary disciplines imply that we are seeking to talk to a broader audience about issues that are important not only as IB/IM phenomena but as phenomena that inform them about critical theories and constructs of importance to their discipline as well. Hence, examination of international joint ventures is critical to those interested in contracts (law), transaction costs (economics) and networks (sociologists). The study of
cultural distance is important to those concerned about individual differences (psychologists), agglomeration (geographers), societies (anthropologists) and so on. If anything, future success in IB/IM will not be whether we can distance ourselves from the primary disciplines but whether we can substantively change those disciplines. To do this we need to think more broadly about to whom we are addressing our research. Something that influences what we view as relevant – it must be relevant to a multiplicity of scholars – why it is relevant – it must be important to both IB/IM and the base disciplines – and how it is done – it must be innovative and not simply an application of approaches that derive solely from a base discipline.

There are two aspects of this that are important. One is what is distinctive about issues that are relevant to IB/IM. The second is how is it that we can address issues in a different way.

For us, there are three critical aspects IB/IM phenomena that make them distinctive and imply that we can add to the managerial sciences in profound ways. First, there is the variance of the phenomena that we study. IB/IM research touches on the boundaries of our understanding of managerial and business issues by opening up the limits to many important constructs. For example, one cannot study organizational structure without addressing the complexity of the MNC as the modern limit to organizational design. Second, there is the complexity of the phenomena that we study. For example, the ‘managerial mindset’ is completely enclosed within a broader notion of the ‘global mindset’. Most traditional HR, strategy, OB and related constructs are simply special cases of broader international conceptualizations. Finally, the structures of our models imply more complex linkages between variables of interest than in traditional models. For example, understanding IB requires the ability to model multiple socio-political environments, something that would be unnecessary (and hence understudied) by examining business in a local context only.

These three critical aspects relate directly to how we address issues, an area where we believe there are opportunities that have remained unexploited. Because of the complexity of the problems IB/IM addresses, it is disheartening that we have, for the most part, done little more than borrow methodologies that have been developed for more restrictive testing. A hallmark of IB/IM research is that we stretch the boundaries of the assumptions of traditional models, yet we apply approaches that do not always account for these violations. Nor have we been overly innovative in the development of new constructs that have found their way into traditional disciplinary models.
THE VOLUME

Looking forward we can see many opportunities if the path chosen is one that recognizes that we are fundamentally part of a larger research program that encompasses an eclectic mix of scholarship but within a frame that is international and multicultural. The various papers in this volume point in a series of directions that we see as potentially provocative but also cognizant of the 60-year tradition on which our work is based. The topics are not exhaustive but point us to different horizons that are worthy of substantive consideration by rising IB/IM scholars.

We have broken the contributions into six sections, each of which are somewhat distinct.

We chose to begin the volume with a companion piece to our own introduction that represents a more philosophical take on IB/IM research (Jonsen, et al., Scientific Mindfulness: A Foundation for Future Themes in International Business and Management). Jonson and his colleagues provide a compelling overarching view of the application of ‘scientific mindfulness’ as guide to thinking about future IB/IM themes. Their questions align directly to our prior discussion of ‘to whom’ do we seek to speak. They argue that the IB/IM research will, in the future, be critical in understanding and contributing to the debate on four key issues: climate change, globalization, inequality and sustainability.

The first section begins with four papers that discuss more general topics of critical relevance to all areas of IB/IM. Ahroni (Behavioral Elements in Foreign Direct Investments) asks the question of why has IB/IM research ignored the revolution in thinking in behavioural economics and evolutionary biology and points out how IB/IM thinking can be enhanced by utilizing a more behavioural, as opposed to economic, sociological or psychological approach. Hutzschenreuter, Han and Kleindienst (Exploring the Role of Managerial Intentionality in International Business) asks the question of ‘where is the manager’ in IB/IM thinking; something that one would believe is even more critical in the IB/IM arena with its more complex decision-making requirements. Finally, van Tulder (The Past, Present and Future of Managing Distance: Stakeholders and Development) brings in the roles of the stakeholder. In many ways his work links to the next section but fits here because of his emphasis on the closer examination of the role of yet another important aspect missing in IB/IM research, that of the role of the stakeholder.

The second section brings a broad array of opinions and conceptualizations of culture and distance. The first three papers by Thomas (Cultural
Intelligence and All that Jazz: A Cognitive Revolution in International Management Research?, Drogendijk and Zander (Walking the Cultural Distance: In Search of Direction Beyond Friction) and Smith (Software, Distance, Friction, and More: A Review of Lessons and Losses in the Debate for a Better Metaphor on Culture) evaluate and critique the cultural and cognitive and social psychological origins and aspects of cultural distance. The next three papers move the conceptualization of ‘distance’ forward by looking at the liabilities of origin and foreignness. Ramachandran and Pant (The Liabilities of Origin: An Emerging Economy Perspective on the Costs of Doing Business Abroad) starts the journey by asking whether your origin matters to how successful you are at internationalizing while also putting the liability of foreignness literature in a broader perspective. Mezias and Mezias (Country Level Corruption as a Liability of Foreignness: Effects on Staffing, Incentives, and Activities) and Bell, Filatotchev and Rasheed (Liability of Foreignness: New Insights from Capital Markets) give us two different applications of the conceptualization of ‘foreignness’. The section concludes by moving the ‘distance’ concept to the level of the institutional structures in a society (Bae and Salomon, Institutional Distance in International Business Research). We see in the progression of these papers a move from micro-level constructs of culture to macro-level constructs relating to institutional structures.

The third section examines IB/IM from within the organization and addresses issues of systems, people and routines. Khilji, Davis and Cseh (Building Competitive Advantage in a Global Environment: Leadership and the Mindset) and Olie (Top Management Teams and Societal Context: The International Dimension of Top Management) follow on from Hutzschenreuter, Han and Kleindienst by addressing the role of managers and managerial thinking and schemas on MNC decisions and performance. Belussi and Sedita (Managing the Fragmented Global Value Chain of Global Business: Exploitative and Explorative Offshoring Toward Emerging Market Economies) ask questions about the form, function and potentialities of value chain disintermediation. Finally, Douglas and Craig (Global Marketing Strategy: Past, Present, and Future) look at the specific history of the singularly most critical management function from an IB/IM perspective, marketing.

The fourth section takes us to the knowledge end of the IB/IM spectrum. This topic is of relevance for the future of the field for two reasons. First, it distinguishes between the creation of new economic value and new forms of value as opposed to the exploitation of existing advantage or the ability to
arbitrage inefficiencies in international markets. Early IB/IM theory concentrated on the MNC as a means of exploiting these latter advantages, while more recent theory (encapsulated in Mol and Birkinshaw, Management Innovation and the Multinational Corporation, and Vives, Asakawa and Svejenova, Innovation and the Multinational Enterprise) emphasize the value creating and process creating aspects of our field’s newer conceptualizations. Second, innovation in its more modern form is considerably more ‘open’ at one level but requires special environments in which to thrive. Mudambi and Swift (Technological Clusters and Multinational R&D Strategy) focus on the role of technology clusters and how they come into play in an MNC’s value-creating strategy.

The fifth section examines the internationalization phenomenon itself. Vissak (Nonlinear Internationalization: A Neglected Topic in International Business Research) asks the question of why we focus on the traditional path models of internationalization (such as the Uppsala model) when the more interesting cases of internationalization involve the violation of this thinking. In many ways it is quite amazing that we hold onto internationalization theory in spite of the number of times in which it has failed to explain the evolution of MNC expansion. Nielsen and Nielsen (A Multilevel Approach to Understanding the Multinational–Performance Relationship) bring in the IB/IM discussion the rising field of multi-level studies. This is an important area in IB/IM research and one where we are a natural testing ground. MNC decision making and structure will generally involve more complex decisions, with more complex linkages amongst the components underlying those decisions, and will involve interacting decisions at many levels of analysis – both horizontally across subsidiaries and product/service divisions and vertically from the individual to organizational levels. For the most part IB/IM researchers have been the earliest proponents of this type of thinking as it is most relevant for the phenomena that we are studying.

Finally, we conclude with two papers examining aspects of emerging markets, one of the hottest topics in IB/IM today. Chand (Diasporas as Drivers of National Competitiveness) takes aim at one of the most neglected topics in IB/IM research, that of key Diasporas that have glued trade together for centuries. Guar and Kumar (Internationalization of Emerging Market Firms: A Case for Theoretical Extension) also pick up on a rising topic, the emergence of emerging marketing multinationals and how we might need to rethink the theory of the multinational to account for their growth.
MOVING THE FIELD FORWARD

Although these papers do not provide a complete overview of the state of IB/IM scholarship, they point to important avenues for moving forward.

Jonsen and his colleagues and van Tulder highlight the importance of institutional gaps and externalities that operate at the international level as a critical area where IB/IM scholars can add significant value both to science and practice. Indeed, our eclectic models and understanding of globalization and its benefits and costs present a real opportunity when it comes to informing debates on climate change, poverty, income inequality and other aspects of international engagement, along with the relationship between civil society and MNCs. To this we would add that one area that has been remote of late in the IB/IM debates is our linkage with the international relations and the international political science community.

A second avenue of fruitful endeavor is seen in the role of managers and top management teams. This theme comes through both in work on cognitive models (Aharoni), managerial intentionality (Hutzschenreuter, Han and Kleindienst), leadership (Khilji, Davis and Cseh) and the structure of top management teams (Olie). It is interesting that although we believe that managers matter to critical decisions in organizations, we do little to capture how those decisions are made and how they flow through to performance outcomes; something the multi-level approach of Nielsen and Nielsen emphasize.

A third pathway open to us is one based on new and better characterizations of the critical conceptions of ‘local’, ‘foreign’, ‘cultural’ and ‘distance’. By this we mean that there is room to better measure these concepts that are so critical to our thinking. They are the ‘hard core’ of our research program (to use Lakatos’s phrasing) and something that pervades nearly every aspect of what we mean when we talk about IB and IM.

A fourth road is opening up in the study of new places and new structures. We would argue going beyond a simple characterization of emerging market studies but asking the question of whether ‘place’ matters. The notion of a Diaspora implies that people can be translocated spatially but still part of the same ‘place’ (Chand). In some sense, the notion of a Diaspora takes on new meaning in a word of online social networking and near instant communication. There is a tendency to overplay the uniqueness of emerging markets as demanding new models and one simply needs to look to the scholastic hysteria relating to the rise of the worker participation model of the 1950s (Yugoslavia), the Japanese economic model of the 1960s and the Asian Tigers of the 1980s to see that few adjustments to existing models
were necessary to explain the growth of these ‘places’ (Guar and Kumar). However, what may be more interesting is the simultaneous rising of vast emerging markets (Brazil, China, India and Russia plus Africa) in conjunction with (or causally related to) the ability to disintermediate value chains and operate virtual organizations that can move in physical space with an ease never before understood.

Finally, we have seen along with this movement of organizations from physical to virtual environments a movement towards control of knowledge architectures and innovation. It has long been understood that a key advantage held by MNCs was their ability to utilize knowledge, systems and processes expansively. The liability of foreignness and the physical fixed costs of multinational operations are partially alleviated by being able to apply knowledge more broadly spatially, more quickly in time and comprehensively across a portfolio of businesses. However, the study of how multinationals do this is still nascent, mainly because we have little effective understanding of what knowledge is or how to measure it. However, our understanding and tracking of the sources and uses of knowledge in the field of innovation give us a picture of how we might address this.

What we see are many areas where IB/IM scholarship can go. We have come a long way from being concerned about organizational models dominated by questions of location and form and individual models focused on country-level differences in people and institutions. If we have learned anything it is that simple conceptions of localization–globalization, national culture, local versus MNC, country and state limit us in our ability to reach out to new and old constituencies in a way that is meaningful to both them and us. Hopefully, this volume is a small part of the way forward.
SCIENTIFIC MINDFULNESS: A FOUNDATION FOR FUTURE THEMES IN INTERNATIONAL BUSINESS

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ABSTRACT

We conceptualize new ways to qualify what themes should dominate the future international business and management (IB/IM) research agenda by examining three questions: Whom should we ask? What should we ask, and which selection criteria should we apply? What are the contextual forces? Our main findings are the following: (1) wider perspectives from academia and practice would benefit both rigor and relevance; (2) four key forces are climate change, globalization, inequality, and sustainability; and (3) we propose scientific mindfulness as the way forward for
generating themes in IB/IM research. Scientific mindfulness is a holistic, cross-disciplinary, and contextual approach, whereby researchers need to make sense of multiple perspectives with the betterment of society as the ultimate criterion.

INTRODUCTION

What the future holds for international business and management (IB/IM) and, as a consequence, which themes will dominate the field, has received much recent attention, as evidenced by publications in journals such as the Journal of International Business Studies (2008, Vol. 39) and Management International Review (2009, Vol. 49). This effort is worthwhile because scholarly research guides and is guided by future practices of the international business community. Griffith, Cavusgil, and Xu (2008) provide a useful entry point to the essential debate on future themes in international business research, and their article is insightful in many ways. In it, they focus on previous contributions to IB/IM research and on themes that are likely to become future trends in internationally focused scholarly journals. The authors used a Delphi technique in which prolific scholars from 1996 to 2006 were solicited for their ideas in order to identify future themes. These experts in the field suggested that a considerable amount of IB/IM research was at best classified as an extension, if not replication, of previous research. This approach follows Buckley’s (2002) recommendation of looking back as the best way forward for IB/IM research and it is consistent with Werner’s (2002) review analyzing trends in top journals. It also speaks to Pfeffer’s (2007) claim that generic review processes in journals generally favor existing beliefs. If this is indeed the case, it is no wonder that the insights of those who already dominate the field are considered good predictors for what lies ahead in IB/IM research. It also explains Tsui’s (2007) observation that important questions in novel contexts and across contexts are ignored by scientists. This classical approach for incremental research is thus of no surprise and has been referred to as “normal science” (Kuhn, 1962).

However, as called for by Van de Ven (2007), we believe the most rewarding, ethical, and sustainable way of improving science in the field is by engaging those external to our closed scholarly circle. In this paper, we revisit the traditional notions of how science progresses within the field of IB/IM. We raise the following questions: (1) Who should be involved in
determining future trends and themes in IB/IM? (2) How should we judge which future research questions are worth exploring? (3) What are the important contextual forces driving the future research agenda? By illuminating these questions, we hope to provide guidance, inspiration, and encouragement to future IB/IM scholars, whatever their background.

Based on our investigation and experience with fieldwork, we illustrate alternative ways of thinking that we believe are needed to shed light on the future of the IB/IM scholarly field and to benefit practice and society. These findings are consistent with the call for change from Pfeffer (2009) who suggests that management research has become (a) disconnected from practice, (b) unconcerned with larger issues of social and human welfare, and (c) institutionalized and thus takes things for granted and as uncontestable. Our approach is conceptual and, following the recommendation of Seno-Alday (2010), we do not attempt to produce alternative “laundry lists” of competing potential themes or predictions. We do not dispute that there is value in articles using traditional methods navigated in fairly closed systems. The research agenda is predictable in the near future because senior researchers tend to strengthen and expand their existing research streams, and doctoral students emulate the approaches of senior researchers. New ideas do creep into the system sometimes, but this only happens when they are already obvious to many.

We ask ourselves some fundamental questions about the best way to identify and judge options for the future IB/IM research agenda. As an international group of researchers, we decided to step back and contemplate these questions as a group during our annual meeting in Istanbul in May 2009 and in subsequent workgroups. This paper is the result of those discussions and further reflections. A subset of the research group membership has written this chapter; therefore, it may not reflect the individual views of each member. It does represent, however, the vigorous discussions that took place among the membership, and it is a perspective that we feel is worth sharing more broadly.

ARE WE ASKING THE RIGHT PEOPLE?
DEFINING THE EXPERTS

We believe that the term experts in the field (used by Griffith et al., 2008, and many others) begs the questions: What experts and what field? If we understand field to mean IB/IM, then we are missing a more diverse
representation of scholars – including those in adjacent sciences and those with non-Western views – and practitioners worldwide. Although science and practice may ask different questions, science should be a process that is based on evidence from the world rather than merely scientists’ opinions of the world (Van de Ven, 2007). As scientists, we cannot assume that the multinational organization (or its members or stakeholders) is an outside actor, standing apart from the social and environmental contexts within which it operates.

Ferguson (1994, p. 82) raised the important question of “who counts as knowers?” and made a call for including more voices in research. More voices can refer to a wider range or different “classes” of people, from practitioners of trades to subcultures in less affluent regions of the world – voices that need representation by those who investigate and are able to write eloquently enough to make scholarly careers out of it. An important voice is that of workers who are not heard presumably because they do not hold positions of power. Yet, their ideas may be critical to the evolution of international business and it is therefore important to include them in the practitioner group.

Today, in the academic world, experts in the field are those who have published the most or have gathered the most citations for their work. This world is characterized by a focus on history and a certain set of underlying assumptions and is based on a system that relies on the exploitation of existing knowledge, constructs, and theories (March, 1991). Citations are used to calculate the impact (factor) of research, but does this mean that scholars who have published the most have the greatest impact on business or society? If impact is solely gauged by being cited and published in the top-rated journal sphere, we run the risk of getting “trapped in the social echo chamber of our own voice” (Pettigrew, 2001, p. S69). Adler and Harzing (2009) have recently discussed this matter in depth and several other authors have investigated the regime of A-journals (Judge, Cable, Colbert, & Rynes, 2007; Starbuck, 2005; Singh, Haddad, & Chow, 2007). Frey (2003) wrote a critical piece on academia claiming that career success for academics depends on their intellectual prostitution. He recommended that scholars should be given (or fight for) more freedom and be treated more like artists. The point is if we limit our information scanning to prolific authors in top journals, we run the risk of incestuous predictions – predictions that are often based on prior research and limited by institutional interpretations of what constitutes rigor and relevance, predictions that don’t make full use of the range of tools available to the futurist, and predictions that neglect important macrolevel changes in
society when determining trends (see Cornish, 2004). Such predictions may or may not come true but they leave us “sleepwalking into the future” (analogy borrowed from Barber, 2006).

Our immediate reaction when discussing this was, “What about practitioners or managers?” As suggested by Czinkota and Ronkainen (2009), practicing managers in international business are a source of ideas for the research agenda. Those of us, however, who regularly work with practitioners know that they operate, for the most part, in a closed system too, although some will accept ideas and approaches from outside their system. This cocooning is unfortunate, as differences between scientists and practitioners are enriching and complementary. There are many examples of great work done as a result of collaboration between scientists and practitioners (cf. Latham, 2001; Saari, 2001).

If we look back in management history, we see that practice and research were more closely joined at one time (Pfeffer, 2009). We propose that this type of collaboration should take place today when we contemplate the future of IB/IM research. There are numerous examples of research emerging from practice, such as inclusion (e.g., Roberson, 2006) – a recent example from diversity research that was driven by organizational practice – and organizational culture, although the latter is perhaps a logical extension of the organizational climate debates of the 1960s and 1970s, it was sparked by popular management books of the early 1980s.

In addition to being informed by practice, we can also “practice” ourselves. Consider, for example, Jacqueline Novogratz, founder and CEO of Acumen Fund, a nonprofit venture capital firm dedicated to understanding and eradicating global poverty. Ms. Novogratz learned the importance of balancing reflection and practice – “letting the work teach you” – as one of her mentors suggested. Through her continued immersion in the poverty-stricken realities of Africa, Novogratz found many of her assumptions just did not hold true. Existing philanthropic efforts to give money away, to grant money in the hopes of stimulating economic activity, repeatedly proved to be ineffective. Novogratz challenged existing assumptions when she found that philanthropy worked best when money was invested in not-for-profit institutions. Her strategy of “patient capital – money invested over a long period of time with the acknowledgement that returns might be below market, but with a wide range of management support services to nurture the company to liftoff and beyond” (Novogratz, 2009, p. 204) – has worked. Acumen Fund has stimulated more sustainable economic activity for the poorest sectors of society than most other past efforts have. Novogratz challenged the prevailing wisdom and developed
alternative models by balancing practice with reflection, by testing her own models and considering the results. IB/IM scholars might learn much from her approach.

The previous anecdote of an outsider solving an insider’s problems raises the question: Do we systematically simplify phenomena of our study, so that we do not have to “live them” in order to suggest solutions or effective practices? Ivancevich and Gilbert (2000) report how most researchers stay outside of the organizational flow and activities, due to archival data, surveys, and secondary databases being the predominant forms of data collection. These authors conclude that researchers therefore make too broad assumptions and that they cannot capture the complexities and the fabric of organizational life. Novogratz (2009, p. 248) suggests, “As our world gets more complex, smart and skilled generalists who know how to listen to many perspectives across multiple disciplines will become more critical than ever.” If this is the wave of the future, are we doing a disservice to practitioners by continuing in our preference for academic elitism? Will our science be better off without their perspectives? We think not. Of course, in science, there is a need for simplification for the sake of understanding, but more importantly, there is a need for (1) understanding the balance of simplicity and complexity, and (2) a willingness to find complex answers to complex problems, as Novogratz’s example shows. If scientists want to advance knowledge and inform practice, they benefit from “practical” perspectives, be it by learning from practice and practitioners or becoming scientist-practitioners.

Generating new and relevant ideas and themes also requires that we study complex phenomena in depth. This is particularly important in studies of culture and management. For researchers to truly understand what is going on in specific countries around the world and thus be able to provide important and meaningful insights into that country’s important issues, it will be necessary for international business scholars to focus on taking an in-depth look at single countries (see d’Iribarne, 1994, 2002, for examples). In doing so, they must explore multiple dimensions of the country they focus on, including the societal, political, governmental, and organizational dimensions. This requires input, thinking, and research from the perspectives of individuals and bodies involved in each of these areas. Several large-scale studies of national or societal culture (e.g., Hofstede, 2001; Schwartz, 1992; House, 2004; Inglehart, Basáñez, & Menéndez Moreno, 1998) have helped focus the field of international business on the differences among nations, and research on societal culture has been extensive (Gelfand, Erez, & Aycan, 2007). Yet, most research has empirically compared
dimensions that were perhaps less universal than its claims, as opposed to comparisons rooted in national history and traditions (see Crozier, 1964; De Maria, 2008; d’Iribarne 1994, 2002). Without taking local context and history into consideration, we run the risk of proposing pseudoglobal applicability of many aspects of international business research, as Özbilgin (2008) aptly pointed out (see Peterson, 2001, for thoughts on context-sensitive international collaboration).

Another example of how our past has shaped our present ways of studying and researching is the notion of national culture. Although it is widely noted that cultural boundaries do not align with country boundaries, the existence of country scores and the ease of drawing on those scores via an Indirect Values Inference approach (Lenartowicz & Roth, 1999) has resulted in substantial literature that empirically treats culture and country borders as equivalent (for a sample of such research, see the review by Kirkman, Lowe, & Gibson, 2006). This is convenient because it allows scholars to study many subjects more easily and communicate their results more easily (e.g., Brewer & Sheriff, 2007; Harzing, 2004). It is also very likely that the nation-as-proxy-for-culture approach has indeed provided practitioners with a better starting point when visiting and dealing with other cultures as some conclusions seem solid because they have been uncontested for decades, such as different interpretations and responses to strategic issues (Schneider & De Meyer, 1991). We do not really know if the end of the nation state is near or not (it has been a frequent claim in sociology and elsewhere since the early 1970s). Nevertheless, many authors in the field of international business are very aware of the problems created by the use of country scores and some have begun to empirically test the influence of intracultural variation (e.g., Au, 1999; Au & Cheung, 2004). Additionally, some researchers have begun to focus on culture at multiple levels of analysis, rather than focusing on societal cultures (see, e.g., Yoko Brannen & Salk, 2000, as well as an upcoming special issue in Journal of International Business Studies).

From the perspective of a multinational corporation (MNC), focusing on heterogeneous cultures provides numerous managerial advantages (Au, 1999). However, focusing on intracultural variation not only reflects “reality” but also has the potential to help provide new research ideas. In addition to exploring the empirical impact of intracultural variation, it is essential that we improve our understanding of the implications it has for theory and practice. Do the types of questions we use to examine an organization, city, region, or society with a high level of intracultural variation differ substantially from those we use in a similar area with a low
level of intracultural variation? Do widely studied concepts represent the same phenomenon in samples that differ substantially in terms of diversity? The variation that exists within a culture and the boundaries that are drawn for different levels of analysis represent opportunities for identifying future research areas.

Rather than treating culture as a variable to be measured and assessed (e.g., Stahl, Maznevski, Voigt, & Jonsen, 2010), an alternative interpretive approach essentially understands culture as a root metaphor for organizations (cf. Frost, Moore, Louis, Lundberg, & Martin, 1985; Pondy, Frost, Morgan, & Dandridge, 1983; Smircich, 1983). The central features of the interpretive approach are laid out by Alvesson and Sköldberg (2000, pp. 58–66) as: a search for tacit meanings rather than causal relationships (deep assumption-level cultural constructs following Schein, 1985), a view of organizational life as narrative or text replete with meaningful symbols rather than data and facts, an understanding of the subjective nature of research versus a purely objective view, and finally, an understanding of the dynamic, interactive nature of culture. Such a paradigmatic add-on may help open the way toward middle-range, process-based theories that might then lead to more dynamic models for understanding the interaction between global leaders, foreign managers, and host country employees.

ARE WE ASKING THE RIGHT QUESTIONS?

If we are not asking the right questions, how do we determine what is right? Adler and Harzing (2009) remind us that the original purpose of universities was to conduct research that contributes to advancing societal understanding and well-being, as opposed to primarily benefiting the careers of individuals or creating knowledge for its own sake and that of its creators.

In seeking answers to the most appropriate questions, we focus on Van de Ven’s (2007) problem formulation step in the engaged scholarship process: What are the problems we are trying to solve? Are they relevant?

Engagement is not done just for socially acceptable, persuasive or enjoyable reasons; instead, it is undertaken out of necessity to learn and understand the problem domain. It’s the research question about the problem domain that drives the engaged scholarship process. (Van de Ven, 2007, p. 268)

Among scientists, the answers to the above questions often have to be framed as the rigor versus relevance debate, which has surfaced periodically
in recent decades (e.g., a seminal issue of the *British Journal of Management*, December 2001, and numerous presidential addresses at the Academy of Management, such as Hambrick, 1994). Recently, we have seen it debated in the *Academy of Management Learning and Education* (March 2009) and the *Journal of Management Studies* (May 2009). Judging research on dichotomies (see Anderson, Herriot, & Hodgkinson, 2001) of rigor and relevance is also common among practitioners who often cocoon and refuse to accept well-founded science in favor of fads (Weick, 2001). Given the tension and ambiguity surrounding this subject, and its seemingly constant recurrence, we wish to remind scholars that the dichotomy of rigor versus relevance is false, insofar as it is not an either/or issue, but a both/and issue. Choosing between rigor and relevance as a criterion upon which research questions are judged is akin to choosing between water and air for the planet. We need both. When there is a conflict, reviewers will favor rigor (Kieser & Leiner, 2009), and therefore, we should not stop attempting to eliminate dichotomy thinking around this matter. Perhaps top management journals fare better than some disciplines in other sciences in trying to emphasize both rigor and relevance, but we believe that there is a long way to go. The success of this journey is largely determined by the ability to phrase the right research questions and at the same time to ensure that these questions are specific enough to be answered with rigor.

How do we find these questions? If our epistemological aim is to create knowledge in the arena of international business, then a central question is what constitutes knowledge in international business versus knowledge in general. We believe that there are knowledge domains that are particularly relevant to IB/IM. We have chosen to work in an arena in which firms have dispersed locations, where businesses operate under different societal rules, institutions, and governments, where individuals are socialized in demonstrably different ways and, thus, misunderstanding occurs more easily. It is not that these things are unimportant in other fields; instead, it is that they are particularly important in our field. Furthermore, Gordon Mitchell (2004, p. 213), in his discussion of social movement rhetoric, criticizes scholars for their lack of reflexivity, for not using their own theoretical tools “back on themselves to illuminate the status of their own scholarship.”

The same criticism could be directed at international business scholars. We need to consider our own cultural roots, our scholarly training, our vision, and the influence these have on what we study, how we study it, and our interpretation of meaning. Who we are affects what we ask and which methods we use to evaluate questions. An epistemological approach leads us
to reflect on what IB/IM knowledge is (Heatherington, 1996). The typical Western approach views the scientific method of validation as superior and the knowledge that results from this method as the truth until science determines otherwise (Kuhn, 1962). In other cultures and contexts, different forms of validation are accepted (such as personal experience). What is perhaps universal, however, is that what is considered to be “truth” must be determined within a particular context (Baba, Gluesing, Ratner, & Wagner, 2004; see also De Maria, 2008; Johns, 2006) – in our case, an international and cross-cultural context. Chris Bangle, the controversial former head of design for the BMW Group (1992–2009), was asked, “Is there a right and wrong in design?” and his response was, “We don’t have an advanced design group, we call it advanced context, because context is everything. Why does the 7-Series [top model competing with Mercedes S-class and Audi A8] sell differently in Asia than it does in Europe? It is a completely different context. A global company with global products has to understand context and then make tough decisions. It is not like one is intrinsically right and one is intrinsically wrong. Design comes in waves and depending on where you are that wave is going to be accepted there or not.” (Dowling, 2004). The point here is a richness of contexts that matter, including location context (e.g., Gunnigle, Murphy, Cleveland, Heraty, & Morley, 2002) and chronological context (timing). This is mentioned with an appropriate warning by Özbilgin (2009) that context must not be framed as a destiny-hindering progression, but rather as a possibility. These contextual aspects are already a central element of thorough review processes, yet they have perhaps been rather neglected in the actual phrasing and development of research questions.

We also wish to highlight here a distinct kind of knowledge called phronesis (Aristotle, 1976), which refers to knowledge that is appropriate in a given situation. It is a practical wisdom that involves making choices between alternative actions in relation to certain values or interests (Flyvbjerg, 2001). Therefore, the notion of practical wisdom helps us in thinking about asking the right questions. Based on the preceding discussion of rigor, relevance, the unique aspects of IB/IM, the identity of its protagonists, and practical wisdom, we can generate the following questions and themes for thinking about the right questions in IB/IM:

How can we expand our knowledge of IB/IM?

1. Historical knowledge – Knowledge from the past
2. Experiential knowledge – Knowledge from practice
3. Existential knowledge – Knowledge from socialization
4. Endemic knowledge – Knowledge from the local context
5. Explicit knowledge – Knowledge from textbook learning
6. Tacit knowledge.

What do we need to understand?
1. Different contexts and how to operate in them
2. How to use multiple disciplines to understand phenomena
3. What lies beneath the artifacts is especially important
4. Wider societal concerns
5. Knowledge from other contexts to meld with our own
6. The demands, and how to meet them, of the multiple stakeholders of IB/IM – those who are influenced and who influence IB/IM research, including top management, investors, employees, customers, society, IB/IM students, NGOs, governments, policymakers, and so on.

What is particularly important in international business in terms of the application of knowledge?
1. Knowledge should be applied in different contexts (e.g., societies)
2. Knowledge should be updated in response to rapid changes
3. Different interpretations of knowledge should be allowed
4. Learning from the “periphery” (e.g., non-Westerners, practitioners, and scholars of adjacent sciences).

WHAT CONTEXTUAL FORCES ARE DRIVING THE FUTURE RESEARCH AGENDA?

We argue that current major global contextual changes that are affecting, and will continue to affect, IB/IM are climate change, economic and social globalization, the technology gap and resultant inequality, and sustainability. These were chosen based on: (a) our close reading of the IB/IM and other literatures dealing with future directions and challenges (for a recent example, see Aharoni and Brock, 2010); (b) the fact that within them are subsumed many of the other issues that are creating complexity, such as terrorism, poverty, and the global financial crisis; and (c) their societal relevance. For example, the recent global financial meltdown can be seen as a result of increased economic globalization combined with an inattention to the sustainability of the free-market system as it has been practiced to date. Thus, these four key issues should play a major role in informing our
view and discussion of international business and serve as fundamental drivers of future research. We acknowledge that there are overlaps between these categories but regard these overlaps as inevitable in such a discussion as this. We feel that the neglect of these contextual changes by IB/IM scholars, while they fill incremental gaps in existing knowledge, corresponds to “fiddling while the world burns” (analogy borrowed from Worldwatch Institute, 2009). Studying phenomena derived from these forces will require what we call scientific mindfulness: a thoughtful approach that is holistic, contextual, and cross-disciplinary (we will return to the theme of scientific mindfulness later).

Climate Change

Climate change (global warming) may be the most critical contextual change affecting international business in the coming decades. According to the Forum 2009 – Human Impact Report on Climate Change (2009), global warming and the environmental damage that results from it will have a greater impact on the world’s population than any other single issue. Because climate change is a global phenomenon, the negative effects of environmental destruction and the consequent social upheaval in one part of the globe will also impact countries (and the companies in them) in other parts of the globe (IPCC, 2007). A recent report (Oxfam, 2009) suggests that in Africa, for example, as global temperatures continue to rise and rainfall patterns change, the Horn of Africa will lose between 80 and 94% of its agricultural activity, and South African net grain revenues will fall by as much as 90% by 2100. As Africa’s agricultural base is eviscerated and its population increases, we can expect an increase in the kind of conflicts we have seen in Darfur and Congo. A study for the US Pentagon predicts that global warming in the 21st century could “…potentially de-stabilize the geopolitical environment, leading to skirmishes, battles, and even war due to resource constraints … Disruption and conflict will be endemic features of life” (Schwartz & Randall, 2003, p. 22). Moreover, given the resultant rapid decline in the already low incomes of these emerging economies, they will find it increasingly difficult to generate revenues that will enable them to build the infrastructure needed to support new business.

The wide disparities in income, safety, and stability across world regions will require international businesses to manage changes, deal with highly volatile situations, think through proper risk assessments, and set up contingency plans. Given the likelihood that climate change will occur in
some regions faster than others, “(d)ifferential warming should affect the allocation of international capital, since investors might perceive regions with high warming rates to be more risky” (Romilly, 2007, p. 475).

This contextual influence suggests a number of research questions including the following:

- How well does the present concept and measurement of “country risk assessment” fit this new reality?
- In what ways do we need to amend our current definitions and approaches to effectively managing country risk?
- How can we manage organizations with diminished resources resulting from global warming?
- How can we manage business transactions between countries that have more resources and those that have fewer resources?
- How will international business help create partnerships and infrastructure to support new technologies to manage risks, uncertainties, change, and resource scarcity?
- What are the interconnected consequences of global climate change that international business managers need to understand?
- How can companies work with emerging economies to develop solutions to the problems arising from climate change?

**Globalization**

Griffith et al. (2008, p. 1225) identify “understanding the role of emerging markets in globalization” and “developing a better understanding of the antecedents, processes, and consequences of globalization” as secondary issues for IB/IM research. However, it is our belief that these so-called secondary issues should be central themes for IB/IM researchers.

Much of the world’s population now sees underdevelopment and its consequences (Kiggundu, 2002) as arising from, or at least exacerbated by, economic globalization (Cavanagh & Mander, 2004). For example, in the 1990s, “…per capita income fell in 54 of the world’s poorest countries…” (Korten, 2006, p. 67) “…and these countries increasingly question the assumptions underlying economic globalization, such as promotion of hypergrowth, homogenization of cultures, adoption of consumerism model, and unrestricted flow of capital and resources” (Cavanagh & Mander, 2004, p. 34). Unless addressed, this could lead to a severe backlash against globalization (Bansal, 2002). Countries with emerging economies are
increasingly looking to multinational companies to address questions concerning how the fruits of globalization should be shared. If globalization is to increase benefits for humanity, its costs and the uneven bearing of those costs need to become a central theme of research in international business. Such research will require multidisciplinary teams of researchers to address questions such as:

- How do global organizations affect the social and economic well-being of the countries in which they operate? Can firms utilize financial and organizational practices to ensure that economic performance does not come at the cost of social disintegration?
- How can economic models be redefined to invite international managers to be more inclusive and compassionate when calculating return on investment?
- Will globalization lead to more identity clashes between international organizations and how will organizations manage internal diversity?
- What is the relationship between organizational structures and governance mechanisms and the distribution of profits across national boundaries?
- Can international codes of conduct and self-regulation lead to a more equitable distribution of profits?
- What business models can improve conditions for disadvantaged groups?
- How do organizations ensure knowledge transfer from developing to developed countries?

**Technology Gap and Inequalities**

As noted by the *Commission on Science and Technology for Development (CSTD)*, “There is a wide gap between those who have access to technology and use it effectively and those who do not” (CSTD, 2006).

It is clear that allowing this gap to widen will only exacerbate poverty, hunger, disease, illiteracy, environmental degradation, and gender inequality among those nations that are underutilizing more advanced technologies (CSTD, 2006). It has also become clear that increases in poverty, hunger, and disease will have a dramatic impact on the entire world not just on the developing nations where these problems may be most acute (Korten, 2006; Cavanagh & Mander, 2004; Forum 2009 – *Human Impact Report on Climate Change*, 2009). Shrinking this technology gap and the resultant equity gap is thus a critical goal for humanity.
We also need to recognize the equally significant gap between those who can create these technologies, those who can access these technologies, and those who can use existing technologies (CSTD, 2006). The technological context raises a number of questions, including but not limited to the following:

- Who is best equipped to take the steps needed to close the technology gap?
- What steps need to be taken?
- How can these steps be identified, and by whom?
- What is the most effective process for implementing the steps that need to be taken and ensuring that they benefit the right people?

**Sustainability**

A fourth global contextual force is the emergence of the worldview of sustainability – “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (Worldwatch Institute, 2009). Sustainability is often operationalized in practice as the *triple bottom line* of simultaneously achieving economic, environmental, and social goals. Several studies have suggested that without equal attention to the social bottom line, the ability to achieve environmental goals will be undermined (Brown, Garver, Helmuth, Howell, & Szeghi, 2009; Dunphy, Griffiths, & Benn, 2003; Osland, Drake, & Feldman, 1999; Phillips & Claus, 2002; Bansal, 2002). Matutinovic (2007) suggests that a new worldview is emerging from the combination of global contextual changes that business now faces. We believe that sustainability represents the spearhead of this emerging new worldview, one that is likely to radically alter the way in which international business is conceived and conducted. This author defines a worldview as a “…set of beliefs, symbols, values and segments of objective knowledge that are widely shared in a given society over a considerable period of time (for at least the life-span of one generation)” (Matutinovic, 2007, p. 1111). A society’s institutions, particularly those that regulate patterns of production and consumption, are shaped by the dominant worldview prevailing in that society.

The worldview underlying traditional international business research, including prediction of future themes, appears to be one in which managers of international business have a neoclassical, linear view of the world economy. In this worldview, the MNC is viewed as an independent actor
within the global system that can choose actions within the global arena (e.g., the configuration of its supply chain, whether to enter a particular foreign market based solely on economic returns, choosing its form of participation in the market) without considering the effects of these actions on the global economic, social, and environmental system. Hence, the topic of sustainability, which is often ignored by “experts” (e.g., Griffith et al., 2008), illustrates how reliance on the past and those who have created this past narrows our research focus at the expense of timely topics.

A new worldview with sustainability at its core suggests a number of important research questions, such as:

- What rules will guide the use of environmental resources to ensure sustainability?
- What emerging institutions (production and consumption) will guide the practice of international business?
- What new requirements will international businesses face for creating new environmentally inclusive business development models and innovative new technologies to meet sustainable development needs?
- What role can MNCs play in the design and creation of these new rules and institutions?
- How will this new worldview affect revenue generation in MNCs?

THE ROAD AHEAD: SCIENTIFIC MINDFULNESS

Because of the complexity and magnitude of these questions, it will be necessary for researchers to engage in what we call scientific mindfulness to generate ideas and themes. In essence, scientific mindfulness is taking thoughtful approaches that are holistic, contextual, and cross-disciplinary. This approach is an extension of what has been termed “Mode 2” of research (see Anderson et al., 2001, p. 393; Gibbons et al., 1994), in which the range of backgrounds and stakeholders involved in knowledge creation transcends the boundaries of traditional disciplines. Beyond simple mode of action, we see it as a foundation for many different kinds of research. Scientific mindfulness opens up the possibility of an interplay between traditional positivist ontologies to include an openness to interpretive as well as radical humanist and structural approaches. As such, scientific mindfulness would typically be characterized by mixed methods triangulations of research (for guidance, see e.g. Marschan-Piekkari & Welch, 2004; Greene, 2007; Tashakkori & Teddlie, 2003) in order to come to a deeper
understanding of today’s increasingly complex organizational phenomena. Studies in IB/IM come predominantly from what Burrell and Morgan (1979) term a positivist or interpretive paradigmatic orientation, with the former enjoying a certain hegemonic position in management studies (Lowe, 2001; Romani, 2008). As such, most research on global firms takes on a positivist ontology in which reality is seen as something “out there,” measurable and objective, independent of the researchers themselves (Burrell & Morgan, 1979). However important the positivist approach remains, this alone may not provide a complete picture when dealing with the complex, embedded, interconnected, and dynamic nature of IB/IM in today’s contexts. The ongoing multifaceted, contextually situated interactions that characterize today’s complex cultural organizations often demand a more nuanced, interpretive, and paradigmatic approach (Redding, 1994, cited in Romani, 2008).

The dominance of the positivist paradigm, especially in culture studies, has led to a epistemology in international business research characterized by a binary logic of “us”/“them” that maps nicely with aggregated value-based dimensions, as put forth by Hofstede (2001) and others (e.g., Schwartz, 1992; House, 2004). The anthropologist Eric Wolf (1982, p. 34; cf. Yoko Brannen, 1994) calls such binary representations “two-billiard ball” understandings of culture. National cultures were often treated as made up of relatively stable value structures. Clearly, when little was known about other cultures (especially in the field of management), the resultant general guidelines for protocol helped expatriates and others crossing cultural boundaries to avoid taking the wrong path by inadvertently insulting their hosts. However, the next step was to treat a country as a context in which existing knowledge or theories could be tested or adapted to new markets; for example, a theory of Chinese management (Barney & Zhang, 2008). These authors propose another avenue that does not begin in the West, namely Chinese management theory. This choice applies to many emerging or emerged markets. The integration of traditional Western research with “the rest of the world” is underexplored and central to the tenet of future IB/IM research and, perhaps, IB/IM itself. The efforts needed may end up “disrupting the hegemony of Western epistemology” (Özkazenç-Pan, 2008, p. 971). Some journals, universities, and research environments have already adapted their structures, processes, and ways of thinking but we believe, nevertheless, that our field still needs to try harder in the endeavor of catching up with a new and flatter world.

Scientific mindfulness features breadth and depth of idea generation. In this mode, ideas and themes are generated using multiple sources of
information and involve multiple levels of analysis and interdisciplinary inquiry. Deep contextual understanding of institutional, cultural, and societal conditions are critical contexts that must be taken into consideration in generating ideas and themes. Thus, a more holistic approach that is at once interdisciplinary and mixed methods holds promise for generating ideas and themes that are both new and influential. It is not the process that we typically see in the discussion sections of empirical papers, where the narrow focus on the empirical research often produces only shallow ideas that are replications or incremental extensions of the existing work. We are often in a situation where scientists formulate problems that correspond closely to those techniques in which they are skilled and experienced (Kaplan, 1964, cited in Weick, 1996). Just as a photographer changes lenses to capture different motives (analogy from Peacock, 2001, p. 74), a scientifically mindful approach requires an exposure of the research question to a larger set of research tools brought to the subject matter by a plethora of researchers and thus better suited to capturing the complexities of today’s complex cultural organizations.

Our conceptualization of scientific mindfulness has roots in other thoughtful conceptualizations of an expansion-of-mind approach. Weick, Sutcliffe, and Obstfeld (1999, p. 88) introduce mindfulness at the organizational level as a thinking style embedding “a rich awareness of discriminating detail and capacity for action.” Martin and Meyerson (2008) talk about the need to look at societal solutions because they say that we have been trapped in incrementalism and institutional interlocks. Nowotny, Scott, and Gibbons (2001) also call for societal inclusion in science as a coevolutionary process. Gibbons et al. (1994) talk about increasing knowledge creation through transdisciplinary and context-accepting efforts. Senge (1990) is a proponent of holistic thinking that includes numerous sciences (see also Senge, Carstedt, & Porter, 2001). Pettigrew (2001) proposes a more contextualist view, inclusion of social sciences and a broader epistemological view, based on conscious pluralism. The idea of holistic science and multidisciplinary complex systems has been proposed by many as a sustainable alternative to reductionism and classic Newtonian approaches (e.g., Hanson, 1995; the Santa Fe Institute, 2009; Stenger, 1999). Finally, Adler et al. (2009) suggest a more holistic focus on societal changes and governmental expectations (among others) in an article in which she and five other AIB fellows describe the future of IB/IM research.

Scientific mindfulness also requires that we invite key informants, such as scholars from adjacent fields and practitioners, into our closed scientific
circle, instead of barricading ourselves behind traditional disciplines such as psychology and economics (McGrath, 2007; Pfeffer, 2009; see also Jonsen, Maznevski, & Schneider, 2010). Forecasting changes in the business environment is critical for policymakers as well as corporate decision makers (Czinkota & Ronkainen, 2009) and a requirement if international business is to be sustained as a legitimate scholarly field. Both rigor and relevance would benefit from wider interpretations of scholars in adjacent disciplines as well as those on the periphery of academia (i.e., outside of scholarly circles).

A good example of the lack of effort to communicate with adjacent disciplines to generate ideas for the future research agenda is the research that has been done on international human resource management. This research tends to focus on expatriates, and sometimes inpatriates, and parent country nationals. However, international business scholars have paid insufficient attention to the largest group of “international” employees – immigrants – those who have established permanent residency in a country other than their home country. This is surprising because immigrants face many of the same issues that expatriates face (e.g., adaptation), and companies that employ immigrants deal with integration and socialization issues that are conceptually similar to those of companies that employ expatriates (cf. Tung, 1993, 2009). Accordingly, research on immigrant employees has the potential to inform research on expatriates and vice versa (Aycan & Berry, 1996). Understanding the reasons for the absence of international business research on immigrants is complex. One might argue that international business scholars are servants to power (cf. Brief, 2000), who assume that studying immigrants is not in the interest of corporate leaders. Alternatively, history may just have been self-perpetuating (we did not study immigrants in the past; hence, we do not study immigrants now) (see also Dietz, 2010), although this self-perpetuation has resulted in a disconnection from emerging themes in the practice of international business. Then again, life in the ivory tower of international business may have kept many scholars from researching in other domains, such as ethnic studies and migration. Obviously, cross-citations of migration and international business journals are rare. Other examples of adjacent disciplines are speed theorists, futurists, and sociology studies regarding “how people live” and “new generations” (e.g., Eriksen, 2001; Lindgren, Luthi, & Furth, 2005; Mogensen et al., 2009; Shirky, 2008). These disciplines could help us determine important international business aspects, from human resource management to consumer behavior and marketing.
CONCLUSION

Our objective in this paper has been to conceptualize a new way of identifying the themes that should dominate the future IB/IM research agenda. We began the discussion with three basic questions: Whom should we ask? What questions should we be asking and which selection criteria should we apply? What contextual forces will drive the research agenda? Exploration of these questions led us to challenge some of the common practices that currently take place in the field of IB/IM research. As a result, we propose the concept of scientific mindfulness as the way forward. Scientific mindfulness is a holistic, cross-disciplinary, and contextual approach, whereby researchers need to make sense of multiple perspectives, from both academia and practice, with the betterment of society as the ultimate criterion.

Griffith et al. (2008) point out, and we concur, that much of the research in the field of IB/IM is contained in silos, with researchers in each silo often working in isolation from one another. New and enhanced means of communication technologies should have increased and accelerated cross-boundary thinking and transdisciplinary approaches around the globe (Gibbons et al., 1994). The internet should have broadened our sources for information and inspiration (see Evans, 2008). However, neither of these tools has had the predicted effect. This is particularly important for idea and theme generation in future IB/IM research. New ideas and innovations are unlikely to come from the foci that currently exist within the field. This is partly because cross-boundary and cross-field collaboration and writing are somewhat of a liability for academics trying to publish in top journals (often even for those who specialize in cross-cultural and international matters), just as “foreignness” is considered a liability for MNCs (Zaheer, 2002). We advocate that a conscious effort be made to expand our view beyond traditional approaches or conventional boundaries. In essence, foreignness and cross-boundary collaboration can be a source of innovation because recontextualizing knowledge can result in new understanding (Yoko Brannen, 2004). In other words, the effort made in crossing boundaries will lead to the consideration of new perspectives, insights, and findings.

In coming to this conclusion, we reviewed previous adjacent discussions such as the dichotomy of rigor versus relevance. In doing so, we realized that the real dilemma falls between advancing knowledge and finding solutions on the one side and the betterment of society on the other side. Ultimately, we cannot separate the levels of organizations and society; thus, we have described the contextual forces that managers and researchers need to take
into account: climate change, globalization, inequalities, and sustainability. Simple mindful questions can relate thoughtfully to the above, such as “How can ten pairs of cotton socks cost less than £2 in Primark on Oxford Street?” We add to Brief’s (2000, p. 352) notion of questioning whom you serve as follows, “Question who you serve and serve the right questions.” In essence, we have sought to provide a platform for reflection on the state of mind with which we engage in our science. In Kantian spirit, we suggest taking IB/IM research to a new level where all players involved in and affected by international business are included – not for the cause of effects, but because it makes sustainable sense and is the right thing to do.

NOTE

1. Members of ION (International Organizations Network). ION was formed with a mission to increase the quality and impact of research on people and their effectiveness in international organizations. The network’s vision is to be a catalyst for the creation and application of knowledge and understanding that powerfully impacts how international organizations are managed.

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A. BEHAVIOR
ABSTRACT

The success of multinational enterprises (MNEs) is at least as much a function of management ability and behavior as it is of industry characteristics or environmental factors. MNE managers, like all managers, display human limitations, e.g., overconfidence that affect judgment. Yet IB researchers still tend to ignore management in their research, treating the firm as a black box. To the extent that the top management team is considered, rational behavior in the classical economic sense is assumed, yet, clearly, managers behave according to different rules than those assumed in much of the IB literature. Further, managers are not part of a herd, but unique. The result of such a lacuna is that theory fails to predict actual behavior and does not allow best guidance for policy options. The paper summarizes research on behavioral decision making and calls for its application in future research in international business.

Nothing is more fundamental in setting our research agenda and informing our research methods than our view on the nature of the human beings whose behavior we are studying. It makes a difference. A very large difference.

(Simon, 1985, p. 303)
There is no general principle that prevents the creation of an economic theory based on other hypotheses than rationality.

(Arrow, 1987)

**INTRODUCTION**

In 1960 I was a young doctoral student. I was distressed by the apparent failure of less developed countries (LDCs) to attract US manufacturing investments. Specifically, I noted that the fervent attempts to encourage foreign direct investments (FDI) by enacting the Law for Encouragement of Capital Investments did not in fact materialize. Therefore, I resolved to study the way foreign investment decisions are made by US manufacturing firms. I hoped that by finding out the considerations businesspersons took into account in making FDI decisions I could unearth ways and means to increase FDIs in LDCs. I assumed that tax incentives permit a higher rate of return and therefore can make otherwise unpromising investments attractive. The conferral of tax benefits will induce foreign investors to initiate projects, which they would not otherwise have undertaken. The problem seemed to be straightforward: how large should the incentives be?

I soon found out that the tax incentives did not play the decisive role I expected them to play. Moreover, the picture emerging from my field research seemed to be one of utterly irrational behavior and a complete lack of economic logic. The decision process had very little in common with the classical economic theory of capital investments. It was necessary to look at the system as a whole, recognizing that decisions are made under uncertainty within an organization and a social system. Once I changed the lens, what seemed irrational made sense.

I submitted my doctoral thesis in 1961. Sometimes thereafter, a spate of publications appeared, which bore many similarities to the major themes of my thesis. One important contribution that laid out a conceptual basis for looking at the decision-making process was *A Behavioral Theory of the Firm* by Cyert and March (1963). I incorporated these contributions and others when I wrote *The Foreign Investment Decision Process* (1966a).

Many things have changed since then. These changes made some theories obsolete and modified the nature of the multinational enterprise (MNE). *New technologies* impacted quite a few firms. Major new products created totally different markets and new industries. Search engines, dial-up modems, and Internet browsers – all mitigate transaction costs; connect people and the dispersed components of MNEs worldwide. The rapid
coverage of the world with Internet facilities changed fundamentally the ways people communicate across borders and the time it takes to respond to a message (Kogut, 2003). One result has been an increased offshore outsourcing of business services – leading Thomas Friedman (2005) to declare that “the world is flat.” Another result is the surge of electronic trade. In addition, in a growing number of industries – e.g., aerospace, telecommunications, or pharmaceuticals – even the largest national market is too small to amortize the enormous research and development expenses associated with new products. The firm must expand into many national markets (Mytelka & Delapierre, 1999).

International operations have grown also because of fundamental changes in the international political environment. World exports have increased from $60 billion in 1950 to $16,070 billion in 2008. The multilateral trading arrangement under the auspices of GATT and later WTO has been a necessary precondition to enable this growth. The General Agreement on Services opened up many avenues for FDIs in services – an area not long ago regarded as nontradable. World trade in commercial services grew from $365 billion in 1980 to $3,778 billion in 2008. In the 1960s, managers of international oil firms were able to maintain market share agreements even during periods of oil glut; generating oligopoly rents through political behavior and collusion (Jacoby, 1974; Moran, 1987; Penrose, 1968). Other firms were able to survive by enlisting political support to prevent imports of more efficient firms. A “political strategy” was an important ingredient to gain competitive advantage (Yoffie & Milner, 1989). Stopford, Strange, and Henley (1991, p. 1) argued, “Firms have become more involved with governments and governments have come to recognize their increased dependence on the scarce resources controlled by firms.” As a result, states have become increasingly dependent on MNEs to achieve technological competitiveness. In some countries, “social partnerships” appear to have been operating without serious frictions, allowing firms to collude to allocate market share (Katzenstein, 1984). However, a collusion strategy may be less successful in some cultures than in others (Eckbo, 1976). Deregulation of many infrastructure services has also created opportunities for more international investment. These changes stemmed to a large extent from changing beliefs. More and more intellectuals – and then government officials – became ardent believers in the efficiency of free markets, or at least disillusioned with the ability of governments to plan and direct the economy. These beliefs led to an almost universal urge to contain the extent of government intervention in the management of resource allocation and to coordinate economic policies,
recognizing the fragility of the international financial system. As a result of globalization, the options open to national governments are severely constrained.

In 1960, US MNEs invested to jump tariff walls and many other national restrictions on trade. Since the 1990s, it is generally accepted that open and competitive markets are necessary to ensure economic growth. The Berlin Wall crumbled in November 1989. Since then, the former Soviet Empire disaggregated, its different components moved toward liberal economic policies. Most economies moved from import substitution policies and protection of domestic firms to policies aimed to achieve export-led growth through reduction of government’s intervention. These policy changes forced domestic firms to upgrade their products and services, trim costs, and benchmark themselves against best-in-class global competitors. Several of these firms also ventured abroad, in search of markets, lower costs, and resources. To be sure, many economic activities, e.g., agriculture or airlines are still highly protected. Capital is being globalized, but national authorities try hard to limit movements of labor across borders. Furthermore, confidence in free market economics, until recently virtually impregnable, has been undermined by the financial crisis of 2007–2008.

The macroeconomic environment has also changed dramatically. The direct convertibility of the US dollar to gold, and the Bretton Woods fixed exchange regime were abandoned. Currencies in the developed world moved to a full float, followed by two oil crises in 1973 and 1979, a decade of high interest rates in the United States, and a debt crisis in many developing countries. The Plaza Accord in 1985 realigned the value of the major currencies and Japanese FDIs zoomed. The Euro Zone was created in 1998; in 1999 the Euro was born (as electronic currency, becoming a cash currency in 2002), and soon rivaled the US dollar as the currency of choice for international business. A financial crisis gripped Thailand, spreading to many Asian countries (Kaufman, Krueger, & Hunter, 1999). All these changes led also to a shift in the distribution of economic and political power in the world. As one example, in 2008, China became the world’s largest manufacturing exporter.

The prevailing views on MNEs were also altered fundamentally. In the world of neoclassical economics, FDI had little place (Kindleberger, 1969). During the 1990s, intrafirm trade (trade within the same MNE) accounted for one-third of all world trade. These transactions are not determined by the market and are valued by the MNE using transfer prices – based on tax and tariff considerations. Another third of world trade is accounted for by the exports of MNE parent firms and foreign affiliates to unaffiliated firms.
Thus, nearly two thirds of international trade in the 1990s was shaped by MNEs (UNCTAD, 1995, p. 193, 1996, p. 121). By 2007, the share of trade within the MNEs, according to WTO, reached 27.5%. In addition, the sales of MNEs’ overseas affiliates (international production) are almost double that of world exports. In the 1960s, MNEs were perceived as new forms of colonialism or imperialism, and as an arm of American hegemony (e.g., Levitt, 1970; Saari, 1999, p. 2). Many scholars portrayed national governments as pawns in the hands of powerful MNEs, impotent and incapable of achieving national goals (Barnet & Müller, 1974). Some observers even claimed that the “nation-state is just about through as an economic unit” (Kindleberger, 1969, p. 207) and would be finished off by powerful MNEs (see Gilpin, 1975, p. 220) that would make the state impotent (for a description and rebuttal of these arguments, see Wolf, 2004, Chapter 11). In the 1970s, such fears led to nationalizations and expropriations of MNE assets, and to efforts to amend the world economic order. The growing anxiety about the possible dominance of MNEs over countries also led to a request by the UN to study the role of MNEs and their impact on the process of development. The result was the first systematic efforts at data gathering by the UN, identifying 7,276 parent MNEs in the world in 1969 with book value of global FDI stock at US$ 108.2 billion. Of the 10 largest multinational corporations, 8 were based in the United States (UN, 1973, p. 77).

Since the 1980s, MNEs have been increasingly recognized as a prime engine to foster long-term economic development. FDIs’ potential to inject capital without debt servicing obligations, create jobs, transfer technology (including management skills), enhance exports, and raise productivity is now widely acclaimed. The possible disadvantages of FDIs or the possible conflict of power between the MNEs and the nation-states seem to have been forgotten or assumed to be manageable. It is now widely agreed that the advantages of MNEs are less based on factors vulnerable to rapid obsolescence and more on the capability to innovate, generate new technologies, and manage knowledge across a global network of subsidiaries. The MNE is, therefore, courted as a major engine of development in a knowledge-based global economy. Different nations compete intensively with each other to get MNEs to locate value-added activities within their borders (Oxelheim & Ghauri, 2004, Ch. 1).

MNEs themselves are constantly changing. First, their numbers are growing – to a large extent as a response to changing environment. From 7,276 firms in 1969, the number of MNEs worldwide mushroomed by 2008 to 82,053 parent corporations with 807,353 foreign affiliates (UNCTAD,
Second, the home country is now spread. Today MNEs come from almost all countries. In 2008, only 2,418 parents were from the United States, while 21,425 parents were from developing countries (Aharoni & Ramamurti, 2008). Third, MNEs were dominated by resource-seeking and manufacturing MNEs. Later, MNEs from the service sector have been steadily increasing their share. In 2008, there were 26 service MNEs among the top 100, compared to 14 in 1993. Fourth, in the 1970s, multinationals were regarded as giants, with sales that dwarfed the GNPs of most countries. This is still true of the largest MNEs. The 100 largest MNEs accounted since 2000 for about 4% of world GDP and to about 9% of foreign assets and 16% of foreign sales of all MNEs. However, the vast majority of firms counted by UNCTAD as MNEs are small in size. Fifth, MNEs are increasingly recognized as market seekers or efficiency seekers, and more and more they are strategic asset seekers – looking for new ideas, attempting “to innovate by learning from the world” (Doz, Santos, & Williamson, 2001, p. 1). Sixth, MNEs shifted from hierarchical organizations to horizontally networked alliances, most of which are not based on equity links. Although in the past FDI has been distinguished from portfolio investment by the element of control – assumed to be a function of ownership – today, in Dunning’s (1994) terms, hierarchical enterprises are being replaced by alliance capitalism – that do not appear in official statistics. One reason is that MNEs disintermediate their supply chain, outsourcing operations that can be digitized and decomposed into a cheap labor location and distributing other activities to the best location across the world. They also interconnect all markets and knowledge centers. FDI inflows according to UNCTAD 2009 reached a historic high of $1,979 billion. As a result of the world recession it went down to $1,697 billion in 2008, and further declined in 2009.1 Again, these figures do not include alliances and other nonequity forms of cooperation. MNEs have become centers of knowledge and innovation. Managers of MNEs orchestrate assets, coordinate development of new products, eradicate inefficiencies, and allocate resources within the firm. New theories of MNEs indeed emphasized learning, capabilities, and innovation (Kogut & Zander, 1993; Augier & Teece, 2007; Pitelis, 2007). More recently, MNEs were recognized as networks rather than as markets or hierarchies. Knowledge within MNEs flows now in all directions within the network, and MNEs are knowledge seekers, not just transferring knowledge from home to their foreign affiliates in host countries (Gupta & Govindarajan, 2000).

The growing sophistication and shrinking costs of transportation and of information and communication technology (ICT) facilitates global
integration of operations. To be sure, the world of business is still mainly a domestic one, and most production is domestically oriented. Large firms operating in a huge domestic market remain in that market as long as they find enough growth opportunities within it. The larger this market, the more can a domestic firm grow and prosper without ever extending its operations to other markets. Firms from small countries (and those operating in large scale, expensive R&D industries) do not enjoy such a luxury. They must enter lucrative foreign markets in order to grow – and the new technologies allow such a strategy. New technologies also foster a major enhancement of cooperation among firms in diverse locations in different parts of the globe. Rangan and Sengul (2009) convincingly argue that MNEs employing more ICT exhibit a reduced propensity for transnational integration. Instead, they cede ownership to foster decentralized value creation. The most recent transformation is the flurry of FDI in the acquisition of farmland (Von Braun & Meinzen-Dick, 2009; Cotula, Vermeulen, Leonard, & Keeley, 2009).

The changes summarized above, were of course noted by other IB scholars. However, and unfortunately, I cannot identify any seminal papers that predicted any of these changes. IB scholars did propose adaptations for theories that became obsolete because of the rapid changes. For example, Vernon’s product life theory (1966) assumed innovations are demand-led and stem from the home (developed) country. This and other parts of his model were discredited with time. Vernon himself acknowledged the impact of some changes in Vernon (1979). Cantwell (1995) has shown that the hypothesis that innovation is concentrated in the home country is not true anymore (if it ever was). In fact, clusters of distinctive innovations occur in many centers and the greater capability of many MNEs manifests itself not just in the wider geographical dispersion of their investments, but in the broader degree of cross-border specialization that they are able to manage. Today, many of the innovations by MNEs originate from subsidiaries rather than from headquarters. Teece (1986) analyzed how an inventor can profit internationally from his new invention. He suggested the need for what he termed “appropriability regime” – e.g., available patent protection as well as the possession of complementary assets and capabilities. Recently, Hennart (2009) pointed out that theories are too MNEs centric – assuming the choice of entry is unilaterally determined by the MNE. He called for recognition of the need to bundle FSA of MNEs with complementary local assets. His model also predicts how entry modes evolve with time. Despite quoting Teece (1986), Hennart assumes that the source of innovation is the MNE, knowledge is transferred from its headquarters and local firms enjoy
domestic market position. In fact in today’s MNEs, FSA can be in
distribution with the innovator being a local firm. MNEs search actively for
technologies, ideas, and products from outside the firm. Procter and Gamble
expects half of its future products to be based on technologies and concepts
it will acquire from third parties (Huston & Sakkab, 2006; Jones, 2005).

In the field of strategy, since the seminal work of Chandler (1962), the
theoretical literature has been growing exponentially. By incorporating ideas
and concepts developed by industrial economics (IO) to strategy, Porter
(1979, 1980, 1985) blazed a new trail in strategy. He made examination of
industry structure a cornerstone of identifying the key factors required for
success. He was followed by many who attempted to connect industry’s
structure and performance of firms, including their international operations.
Another strand – the resource-based view (RBV) – offered an explanation
for interfirm variations in performance. Its central tenets are path
dependence and firm heterogeneity. Firms are able to sustain competitive
advantage because of the ownership of firm-specific resources that must be
valuable, rare, inimitable, and nonsubstitutable (VRIN) (Barney, 1991). As
the external environment changes, firms need to renew their stock of VRIN
resources. Dynamic capabilities are needed to cope with changing
environments (Teece & Pisano, 1994). These capabilities and the strategic
decisions are made by top management teams (TMTs) – the study of which
builds on upper echelon theory (Hambrick & Mason, 1984). These studies
also influenced the IB field. Many recent IB studies stressed the salience of
experience, knowledge, as well as path dependence – an evolution of the firm
that depends on its past history. Indeed, Jones and Khenna (2006)
convincingly argued that “history matters.”

One thing did not change: the lack of information about alternatives and
the impossibility of foreseeing the future makes managers of MNEs
“satisficers.” Their rational behavior is bounded by the cost of obtaining
information, by their cognitive ability, and because they are working under
uncertainty within a social system. A whole new field of economics was
developed – stressing behavioral elements, cognitive bias leading to a search
in a relatively familiar domain, and other seemingly irrational behavior,
including the malleability and context dependence of preferences and
behavior. Yet, despite the rich findings of behavioral economics, behavioral
marketing, and behavioral finance, it is quite amazing that “the role that
managers play in achieving certain internationalization positions is, to a
great extent, underdeveloped in the IB literature... One important
commonality is that they do not leave much scope for discretionary
management decision-making” (Hutzschenreuter, Pederson, & Volberda,
Most IB researchers assumed perfect rationality in their models and managers do not have any role (Kogut, Walker, & Anand, 2002). To the extent individual managers are incorporated into conceptual frameworks, it is assumed they act based on their own self-interest or, if appropriate, governance mechanisms are in place, in accordance with interests that are aligned with that of the MNE’s owners (see Carpenter, Geletkanycz, & Sanders, 2004; Werner, 2002 for reviews). It is tempting to speculate why IB did not incorporate bounded rationality, decision-making biases, and judgments by managers in their models. It may be more constructive to enumerate these findings, hoping that future researchers would consider their meaning. In the following sections I shall summarize my findings on the foreign investment decision process and the important advances in behavioral theories. I shall then demonstrate the relevance of behavioral findings in prescribing policies and enumerate future research implications.

THE FOREIGN INVESTMENT DECISION: A COMPLEX PROCESS

The foreign investment decision process is not a single, identifiable act. Rather, it is a complex succession of acts. It is “a dynamic social process of mutual influences among various members of an organization, constrained by the organization’s strategy, its resources and the limited capacity, goals and needs of its members, throughout which choices emerge” (Aharoni, 1966a, p. 15). The foreign investment decision process is made by a group of individuals in an organization all of which are busy. It is a long process and involves different organizational levels. The process is made under uncertainty both because of lack of information and because of the limited capacity of the human mind. The decision process starts because of an outside force that causes a decision to look abroad. The strength of this force determines the investigation process – throughout which decision makers accumulate psychological commitments toward other organizations and individuals. The more committed they become, the higher the probability of a decision to invest. In this sense, the decision to invest is not necessarily the last part of the decision process. Thus, if the force that caused the look abroad is strong enough, the decision to invest abroad is already made and the investigation process may concentrate on minimizing the size of the investment and the risks involved. The process is changing with the
accumulation of experience and the result of organizational modifications such as the creation of an international division.

Any decision process includes several elements. First, any choice made by an organization depends on the social system. The social elements focus on the decision maker’s relations with other individuals both within and outside the MNE, such as customers, suppliers (including financial suppliers), government agencies in host and home countries, and competitors. Second, the process takes a long time. Third, decisions are made under uncertainty. Therefore, the decision maker’s perception of uncertainty is a major element. This perception changes as a result of experience and knowledge. Decision makers also vary in regard to how comfortable they are with uncertainty surrounding the decision. Fourth, organizations have goals. Finally, there are many constraints on the freedom of action of the decision makers.

The decision-making process is spread over a long period of time. Implicit and explicit negotiations, both inside the organization and with outsiders, may drag on for years. During that period there are many changes; it is often found that certain factors were not taken into account, or proved to be unpredictable. These changes invariably require more modifications, more approvals, and sometimes a new round of negotiations has to be started.

When a series of investment decisions are examined, another important factor emerges: “the accumulation of experience by executives in various echelons regarding foreign investments creates profound changes in the organization itself . . . Gradually, organizations may evolve into multinational corporations, vigorously looking for opportunities abroad” (Aharoni, 1966a, p. 174). Organizations learn, and with learning the perception of uncertainty in foreign operations changes. Investments previously perceived as risky become acceptable. When the process is put in a historical perspective it may be found that the firm received an export order a long time back in the past. The foreign market was developed by a foreign agent, with the top management paying little or no attention to foreign development. With the growth of export business, sometimes even without any deliberate action from headquarters, an export department may have been created. This, in turn, forms a group of people in the company who feel obligated, driven by their vested interest, to expand the international operations. The very existence of an international division gives a momentum to international operations, and these operations are expanded. The assignment of a group of executives to an international division creates several institutional as well as individual commitments. The cost of investigation in an international division is generally lower: knowledge has
been accumulated from previous investigations. Further, both because of their role and because of their experience, the international executives perceive the risk of foreign operations to be lower. They have more knowledge about remote control operations. With time, foreign investments become a substantial part of total operations. The level of the international division in the firm’s hierarchy is much higher and the involvement of top management increases. When the expansion of existing foreign operations is considered, the investigation is much more expeditious.

The location pattern also evolves: very often Canada was the first country selected for foreign operations. The Canadian subsidiary exported to the British Commonwealth. “Most United States investments in Asia and Africa have been made by companies which have had considerable experience in foreign operations in more developed countries. This phenomenon may perhaps be attributed to the idea of “experience first”: companies may have preferred to get their feet wet in safer water” (Aharoni, 1966a, p. 180). Because of path dependence, the history of the firm is an important variable.

The population I studied was US firms. A similar incremental process of learning and experience, as well as the choice of familiar countries first was found by Johanson and Vahlne (1977) in their observations of Swedish firms. Firms are inhibited by lack of knowledge about markets. Therefore, firms proceed in small steps, adjusting as they gain knowledge through experience. The internationalization is an evolutionary, continuous process from export, to joint venture representation, to sales subsidiary, to resource development subsidiary. Further, based on experience and knowledge acquisition, firms enter new markets with successively greater psychic distance. These explanations are considered at the firm level – not at the individual level. “In our model, we consider knowledge to be vested in the decision-making system. We do not deal explicitly with the individual decision maker” (Johanson & Vahlne, 1977, p. 26).

In subsequent works, Johanson and Vahlne (1990, 2009) expanded the notion of knowledge development to include knowledge gained through relationships with other bodies on the foreign market. They posit markets as networks of relationships among firms. Insidership in relevant networks is necessary for successful internationalization. Relationships offer potential for building trust and commitments, which, in turn, shapes a firm’s market knowledge.

IB theory developed significantly since the early attempts to understand the foreign investment decision process, the modes of operations and the sequence of entry to different locations. An extensive academic literature
used cross-sectional design to study the choice of modes of operation. Brouthers and Hennart (2007) have documented about 100 empirical studies in the past 15 years. Most of these theoretical developments relied heavily on the pioneering efforts of Coase (1937) to explain the existence of firms. Coase stressed the relative costs of internalizing transactions vs. operating in external markets. Williamson (1975) developed the transaction costs approach to a general theory of the firm. Buckley and Casson (1976) combined internalization with location effects – portraying the MNE as an internal market operating across borders. Other researchers followed Williamson’s transaction cost theory (Hennart, 1982; Anderson & Gatignon, 1986). Dunning (1980) offered a theory attempting to combine the role of ownership and location advantages in explaining why an MNE would engage in FDI – thus demonstrating an advantage – rather than exports. This theory was later presented as paradigm – that was updated many times (for the latest version, see Dunning & Lundan, 2008). Later, influenced by resource-based theory and premised on the idea that organizations learn from experience (Levitt & March, 1988), the MNE was recognized as knowledge based (Kogut & Zander, 1993). Organizational learning theory is primarily concerned with experience accumulation. It also addresses knowledge articulation and knowledge codification (Zollo & Winter, 2002).

These theories were all based on some – often implicit – assumptions about human behavior. Williamson, for example, relied heavily on bounded rationality and also assumed opportunism, defined as self-interest seeking with guile (Williamson, 1985). Indeed this assumption was the major reason for rejecting the application of TCE to practice (Ghoshal & Moran, 1996). Other theories ignored managerial behavior totally. As pointed out by one of the founders of internalizing, Mark Casson, “Transaction cost analysis ... explains the boundaries of the firm very well ... What lies inside the boundaries of the firm is not explained so well because this is not the focus of the theory” (Casson, 2000, p. 118). It seems that many of the IB scholars were willing to assume that managers are omnipotent, possessing all the information needed to make rational decisions. As a minimum, it is assumed “that the decision-maker can identify a set of options, and has an objective by which these options can be ranked, and an ability to identify the top-ranked option and select it” (Buckley & Casson, 2009, p. 1568). Thus, the vast literature on entry mode choice tends to assume that firms will move their transferable FSAs to locations enjoying country-specific advantages (CSAs). Based on the relative strengths of the CSA, the MNE would choose both the initial and the subsequent modes of entry. It is taken for granted that all the relevant information is known. To be sure, relevant does not
imply complete. “A rational decision-maker will collect only sufficient information to make the risks surrounding the decision acceptable” (Buckley & Casson, 2009, p. 1568). What is sufficient, how is the information collected and evaluated, how the decision maker knows which information to collect, and what is an acceptable risk are left unanswered.

The OLI paradigm also assumes rationality in the classical economic sense. The behavioral elements in decision making were unfortunately ignored. Theoretical developments, clearly demonstrating departures from rationality both in judgment and in choices were extensive – as will be shown in the next section.

THEORETICAL DEVELOPMENTS ON BEHAVIOR

In 1955, Herbert Simon received the Nobel Memorial Prize for his ideas on behavior of bounded rational actors. Simon criticized the classical economists’ rational choice model and the reliance of economists, following physics, on equilibrium as unrealistic. Simon pointed out that because of their cognitive limitations bounded-rational actors do not attempt to maximize profits or utility. The rationality of individuals is limited by the information they have, the cognitive limitations of their minds, and the finite amount of time they have to make decisions. Decision makers lack the ability and resources to arrive at the optimal solution; they instead apply their rationality only after having greatly simplified the choices available (Simon, 1947, 1955; March & Simon, 1958).

Since Simon, behavioral theories have undergone steady development on different fronts. One has been information processing psychology, using computer simulation. Extensive empirical evidence demonstrates that problem solving involves selective search, based on rules of thumb or “heuristics.” Over time these rules of thumb change as outcomes are evaluated. The same process was shown in decisions on investments in securities or medical diagnosis and in many other case studies of organizational decision making (Newell & Simon, 1972).

Another major field has been the empirical refutations of the theory that human beings maximize subjective expected utility (SEU) – reported mainly by Kahneman and Tversky, but also by Kunreuther and his colleagues (1978) in studies of individual decisions to purchase or not to purchase flood insurance. Kahneman and Tversky (1979) and Tversky and Kahneman (1974), based on a series of experiments in different countries, developed a theory they termed prospect theory. It distinguishes two phases in the
decision-making process: an editing phase, which is a preliminary analysis of the offered prospects, and an evaluation phase, which is when the prospect with the highest value is chosen from among the edited prospects. They also demonstrated a certainty effect – meaning people overweight outcomes that are certain, relative to outcomes which are merely probable, even when the expected value of each is the same. People tend to avoid a loss, even if it means taking even greater risks. Loss aversion might depend on framing the safer option as the status quo, and the complexity of the suggested alternatives. Thus, cognitive limitations preclude the use of the laws of statistics to process information.

In order to simplify the choice between alternatives, people frequently disregard components that the alternatives share and focus on those which distinguish them. Since different choice problems can be decomposed in different ways, this can lead to inconsistent preferences. Kahneman and Tversky (1979) call this phenomenon the isolation effect. Prospect theory replaces the notion of utility with value. Whereas utility is usually defined only in terms of final assets, or net wealth, value is defined in terms of gains and losses relative to a reference point (framing effect) (Tversky & Kahneman, 1981). Decision makers may be more risk averse when they frame a strategic decision as potential for loss, and less risk averse when a decision is framed as potential for gain (March & Shapira, 1987; Miller & Chen, 2004). Attitudes of persons toward risk are very different when gain is concerned compared to when loss is anticipated. For losses the value function is convex and relatively steep, while for gains it is concave and not quite so steep. Second, the value of each outcome is a function of “decision weights.” These weights do not always correspond to probabilities. Specifically, prospect theory postulates that decision weights tend to overweight small probabilities and underweight moderate and high probabilities. Reference points are selected based upon internal capabilities and external conditions considered over time (Shoham & Fiegenbaum, 2002). Decisions have two elements – judgment and choice. Judgment research deals with the processes people use to estimate probabilities. Choice deals with the processes people use to select among actions, taking account of any relevant judgments they may have made. Judgment was shown to be based on extrapolation, overconfidence, and optimism.

In their 1992 paper, Tversky and Kahneman developed an updated form of prospect theory, which they termed Cumulative Prospect Theory. The theory incorporates rank-dependent functions, which transform cumulative, rather than individual, probabilities, and satisfies stochastic dominance, which the original form of prospect theory does not.
Prospect theory helps to illuminate experimental results that show that individuals often make divergent choices in situations that are substantially identical, but which are framed in a different way. Therefore, managerial choice is not determined uniquely by the objective characteristics of the problem situation. Rather, it depends on the particular heuristic process that is used to reach the decision. Prospect theory has had an enormous influence across a range of disciplines, including economics, marketing, finance, and consumer choice.

Several theories of business firms incorporated bounded rationality. Cyert and March (1963) and Cyert and DeGroot (1974) incorporated adaptive learning, and Nelson and Winter (1973) stressed evolution. In these theories, profit maximization is replaced by goals defined in terms of targets. A mechanism of some sort, e.g. “organizational slack,” prevents maximization. Organizational learning could help to reach maximization equilibrium but only if the environment remains unchanged for a very long time. Even if the environmental conditions are identical, different decision mechanisms can produce different results.

More than 40 years after the publication of A Behavioral Theory of the Firm, Organization Science published a special issue (Organization Science, 2007) reporting on the most recent research in this area. None of the papers in that issue – not even any of the hundreds of papers cited – is in international business! The most direct descendents of Cyert and March’s work are presented as the organizational learning (Argote, 1999) and evolutionary economics (Nelson & Winter, 1982). In both fields, process-oriented models are important. “In these fields, much theorizing concerns how certain events and experiences set in motion processes of decision making, routine, development, or routine selection that change organizational behavior” (Argote & Greve, 2007, p. 338). Lessons learned are captured by routines such that the lessons are accessible to organizational members. Both used the behavioral theory as a tool for providing basic concepts on which they could build a theory of change. Organizational learning theory has helped to explain the formation, performance, and likelihood of survival of international joint ventures (Barkema, Shenkar, Vermeulen, & Bell, 1997; Parkhe, 1991).

Behavioral economists, too, challenged conventional economic analysis, modifying unbounded rationality, unbounded willpower, and unbounded selfishness, and adding significant behavioral findings to today’s mainstream economics (for reviews, see Camerer, 2000; Camerer, Loewenstein, & Rabin, 2003; Fudenberg, 2006; Rabin, 1998, 2002; Sunstein & Thaler, 2008; DellaVigna, 2009). In 1997, a special issue of the Quarterly Journal of
Economics was devoted to behavioral economics. Areas of research by behavioral economists include anchoring (a cognitive bias one relies too heavily on, one trait or a piece of information), availability heuristic (when people predict the frequency of an event based on how easily an example can be brought to mind; one result is that people tend to overstate risks and as a result purchase unnecessary insurance, or governments pursue social goals at the expense of other more fruitful ones), representativeness heuristic (where people judge the probability or frequency of a hypothesis by considering how much the hypothesis resembles available data), status quo bias (when people are very likely to continue a course of action since it has been traditionally the one pursued), and herd mentality (where people are heavily influenced by actions of others). It also includes loss aversion (Tversky & Kahneman, 1991), quasi-hyperbolic of intertemporal choice (Laibson, 1997), cognitive dissonance (Akerlof & Dickens, 1982), endowment effect (the tendency to place a greater value on an item when it might be given up from one’s possession than when it is not in one’s possession) (Knetsch, 1989; Knetsch & Sinden, 1984; Kahneman, Knetsch, & Thaler, 1990), social preferences (Gneezy & Rustichini, 2000a, 2000b), fairness (Kahneman, Knetsch, & Thaler, 1986), and mental accounting (Thaler, 1999). Rabin demonstrated that people cooperate in ultimatum games – in which a proposer suggests to a respondent how much of a given sum each should get. If the respondent rejects the offer both get nothing. If the respondent accepts, both get what was offered. Economic theory would predict the proposer would offer a token amount. Experiments show respondents reject offers of less than 20% – because of “fairness” (Rabin, 1993). As another example, Camerer, Babcock, Loewenstein, and Thaler (1997) studied New York cab drivers. The profit maximizers should work hard in good days and quit early on bad days. Instead the cabbies had a target earning, treating shortfalls from target as a loss. They thus quit early in good days and worked longer on bad days.

Arieli, Loewenstein, and Prelec (2003) following the reference ideas of Kahneman and Tversky, provided some reference values to their subjects and then asked them what compensation they would require to hear an unpleasant sound for a certain duration. The subjects quoted arbitrary values linked to the reference values. When the subjects were asked to quote the price they would want for longer durations, they quoted values consistent with the initial price. When the initial price is arbitrary and the subsequent price consistent with the initial price, the behavior is termed coherent arbitrariness. We do not value goods (or shares) based on “fundamentals.” The experiments show that this combination of coherent
arbitrariness (1) cannot be interpreted as a rational response to information, (2) does not decrease as a result of experience with a good, (3) is not necessarily reduced by market forces, and (4) is not unique to cash prices. The results imply that demand curves estimated from market data need not reveal true consumer preferences, in any normatively significant sense of the term.

A famous study conducted by Solomon Asch clearly shows peer social pressure can make a person say something that is obviously false. These errors and mistakes that human beings are subject to are well summarized by Sunstein and Thaler (2008). They also coined the term choice architecture – or the way in which decisions are influenced by how the choices are presented. The book asserts that “the notion that each of us thinks and chooses unfailingly well, and thus fits within the textbook picture of human beings offered by economists,” is false (Sunstein & Thaler, 2008, p. 6). Unlike members of homo economicus, human beings make predictable mistakes that are the result of widely occurring biases, heuristics, and fallacies, and because of the way they are influenced by their social interactions. Behavioral research raises “serious questions about the rationality of many judgments and decisions that people make” (Sunstein & Thaler, 2008, p. 7). While behavioral economists, following Tversky and Kahneman, present human thinking as riddled with irrational cognitive biases, Gigerenzer, who have written extensively on heuristics and decision making, conceived rationality as an adaptive tool that is not identical to the rules of formal logic and probability calculus (2006, p. 129). Gigerenzer and Selten, 2001 includes a collection of original papers outlining an approach to bounded rationality that moves further away from the standard rational choice model than most works of behavioral economists.

In the past decade or two, a new branch of economics termed neuroeconomics attempts to combine economics, behavior, and scanning of the brain, or use eye tracking and pupil dilation in order to compare the roles of the different brain areas that contribute to economic decision making (for reviews, see Camerer, Loewenstein, & Prelec, 2004, 2005). In one study, Rubinstein (2008) found different patterns of choice among fast and slow respondents among subjects who were asked to express their preferences in the context of the Allais Paradox. He suggests that we try to identify types of economic agents in the time they take to make their choices. For him, one potentially important task for the neuroeconomics approach is to identify “types” of economic agents, namely to determine characteristics of agents that predict their behavior in different choice problems. It is difficult to do this simply by observing behavior.
Behavioral economists attempt to merge psychology and economics. Most of their studies concentrate on the behavior of individuals. Behavioral finance experts study behavior of individual investors. Many behavioral studies were carried out by marketing experts – trying to understand how consumers make choices. Organization science experts attempted to integrate prospect theory into organizational literature and behavioral decision theory (Slovic, Fischhoff, & Lichtenstein, 1977). Significant attention is paid to issues of managerial decision making (Miller & Chen, 2004; Schwenk, 1995) and commitment (Schwenk, 1986), and for a search of new and increasingly complex biases and heuristics (e.g., Gilovich, Griffin, & Kahneman, 2002; Kahneman, 2003).

One important issue is the consequences of the rapid pace of technological change. Industries, institutions, and the knowledge and skills that constitute core capabilities are under a relentless onslaught and unremitting assault of change. Firms have difficulties in adapting and core capabilities may become core rigidities. These difficulties are clearly a result of behavior of managers – not of rational economic calculations. Thus, Christensen (1997) demonstrates in a study of the disk drive industry the difficulties managers face in changing strategy when what he termed disruptive – as opposed to sustaining – technologies are discovered. Trispas and Gavetti (2000) analyzed how managers in Polaroid coped with the arrival of digital imaging. They provide an example of where mental filters impede evolution of core capabilities in the face of radical technological change. As the digital image technology evolved, Polaroid were successful in developing digital image technology, but stayed with their original business model and failed to develop manufacturing and product development capabilities, which prevented them from competing efficiently in this new market (Trispas & Gavetti, 2000). In all of these cases and many others managers’ mental models can reduce the companies’ ability to react to changes in their environment (Foster & Kaplan, 2001). Managers develop an implicit mental success model and use it as a mental filter to sort information and make decisions in their daily work (Ansoff & McDonnell, 1990). When the environment in which the company is acting is changing, a new mental filter must be developed. As long as signals of change in the environment are handled according to an old mental filter, the acceptance of new realities will be delayed, which could affect the information system, decision-making process, executive capabilities, and control system (Foster & Kaplan, 2001; Ansoff & McDonnell, 1990). In the world of the 21st century, characterized by a relentless pursuit of new technologies and dynamic markets, mental processes that facilitate rather than hinder adaptation to new environments
are of great importance. When managers face fading product-market
domains they are often inertial in their response to such decline. Martin and
Eisenhardt (2004) call for a corporate entrepreneurship response whereby
managers move their businesses into new market opportunities as the value
of current market domains inevitably begins to fade. They emphasize exiting
from declining markets while simultaneously capturing and exploiting
opportunities in more promising markets.

Managers are often overconfident (Biais, Mazurier, & Puget, 2005;
Kőszegi, 2006) and their forecasts suffer from hubris (Hayward &
Hambrick, 1997). They therefore fail to consider adequately the possible
impact of rare but earth-shattering events (Taleb, 2007). In fact, delusional
optimism is one of the forces that drive capitalism – because managers are
overconfident and so are entrepreneurs “… forecasts of future outcomes are
often anchored on plans and scenarios of success … and are therefore overly
optimistic; … evaluation of single risky prospects neglect the possibilities of
pooling risks and are therefore overly timid” (Kahneman & Lovallo, 1993,
p. 17; see also Camerer & Lovallo, 1999; Lovallo & Kahneman, 2003).

To summarize, studies of the psychology of decision making acknowledge
human limits on computational power, willpower, and self-interest. They
posit functional heuristics for solving problems that are often so complex
that they cannot be solved exactly by even modern computer algorithms.
They show that decision makers are influenced by a wide range of factors,
such as personal goals, evaluation criteria, and identity. They sometimes
make choices that are not in their long-run interests and are often willing to
sacrifice their own interests to help others because they care about fairness
and equity. They evaluate their position relative to others and follow social
norms. They may make mistakes because of several factors. First, cognitive
biases impair decision makers’ abilities to select optimal choices (Barnes,
1984; Schwenk, 1984; Clapham & Schwenk, 1991). Second, they transform
intractable decision problems into tractable ones by using routines that
short-circuit individuals’ autonomous judgments (Nelson & Winter, 1982;
Teece, Pisano, & Shuen, 1997). Third, managers are overconfident in their
judgments and read information in self-serving manner. They make
decisions based on delusional optimism rather than on a rational weighting
of gains, losses, and probabilities. They overestimate benefits and under-
estimate cost (Malmendier & Tate, 2005; Lovallo & Kahneman, 2003).
An alternative explanation suggests that promoters of projects strategically
overestimate benefits and underestimate costs in order to increase the
likelihood that “their” projects, and not those of others would be approved
and funded (Flyvbjerg, 2003, 2008). Fourth, managers are dominated by
superior logic that orients behavior and results in blind spots and escalation of commitments (Prahalad & Bettis, 1986; Coff, 1999; Staw & Ross, 1987) and may be dominated by inertia. Further, organizations may develop more blind spots even beyond any individual constraints. Research to date emphasized individual behavior – and less so organizational responses (Das & Teng, 1999).

Two streams of research should be briefly mentioned: TMTs and MNE governance. Both recognize the influence of executives; e.g., in determining international strategies. TMT research builds on upper echelon theory (Hambrick & Mason, 1984) to explore the role of TMT in making international business decisions. The upper echelon perspective focuses on executive cognition, perceptions, biases, and values, and their influence on strategic choice (e.g., Khilji, Davis, & Cseh, this volume; Olie, this volume). Managers face information overload, ambiguous cues, and competing demands. Complex decisions require reliance upon simplification heuristics, making cognitive processes increasingly important (Einhorn & Hogarth, 1981). In upper echelon studies, biases and heuristics are assumed to be relatively consistent across similar demographic characteristics such as age, functional background, and educational experience. Empirical research has linked upper echelon characteristics and experience with strategic choices such as internationalization (Carpenter et al., 2004). However, there are significant problems with using individual-level demographic variables as indicators of decision making in TMTs (e.g., Lawrence, 1997). Markóczy (1997), for example, suggests that individual demographic characteristics are poor measures of managerial cognition. Kilduff, Angelmar, and Mehra (2000) found no evidence of any effect of demographic diversity on cognitive diversity. Similarly, Priem, Lyon, and Dess (1999) encourage TMT researchers to eschew demographic variables in favor of measures that are more difficult to capture. Others have added that, even if demographic characteristics are representative of cognitive constructs, they cannot be treated independently because executives embody a bundle of attributes that continuously interact with each other (Harrison, Price, & Bell, 1998). A few studies of TMT deal specifically with internationalization. Thus, Herrmann and Datta (2005) examine the relationships between TMT characteristics and international diversification among large, internationally diversified US-based manufacturing firms. Findings indicate that firms with higher levels of international diversification are likely to have TMTs characterized by higher educational level, shorter organizational tenures, younger executives, and greater international experience. In addition, findings indicate that the relationships between TMT characteristics and
international diversification are more dominant in better-performing firms than in lower-performing firms. Glunk, Heijltjes, and Olie (2001) found that the national diversity of TMTs in Sweden and the Netherlands have not progressed in proportion to the level of internationalization of the companies.

An alternative perspective to upper echelon research is offered by agency theory. The managers – the agents – have substantial discretion as to the actions they take because the principals – the shareholders – are dispersed and cannot coordinate to share monitoring and control costs (Jensen & Meckling, 1976). The managers pursue private benefits. The divergence of interests is greater the lower the managers’ equity stake and the lower is the likelihood of them getting caught and punished for non-value maximizing behavior. Another problem identified by agency theory is that of entrenchment: top executives with high equity stakes enjoy more freedom to misallocate resources (Stulz, 1988). These executives cannot be removed in a proxy fight or cast out by hostile raiders attracted by low share prices. Jensen and Meckling (1976) argue that if ownership gives the TMT an incentive to assume risk, and aligns their goals with those of other firm owners, they have less incentive to misallocate corporate resources. Stulz (1988) argues that higher equity stakes gives insiders more freedom to misallocate resources in the corporate decision-making process.

In these studies, managers are portrayed as motivated by their own gains – at the expense of the owners of the firm. They ignore studies that clearly demonstrated that fairness is an important motivator. It may well be that managers are motivated by ego and want to do better than the competition. They demand higher remuneration or a larger bonus only because they compare their paycheck to those of others (see Arieli, 2008). Further, most of these studies are based on the experience of the United States with its separation of ownership and control. Morck, Wolfenzon, and Yeung (2005, p. 655) review a very large body of studies. They point out, “outside the United States and the United Kingdom, large corporations usually have controlling owners, who are usually very wealthy families. Pyramidal control structure, cross-shareholding, and super voting rights let such families control corporations without making a commensurate capital investment.” Their paper reviews many studies of different countries. They offer several conclusions: (1) The corporate governance problem in most countries is that of a conflict between the controlling shareholder and public shareholders – not a conflict between atomistic shareholders and professional managers; (2) The highly concentrated control leads to a range of market power distortions and may curtail investment in innovations;
Public policy is much influenced by the power of the rent-seeking controlling groups. Clearly, if one looks for viable policy prescriptions, it is crucial to base public policies on a coherent understanding of behavioral elements that affect the decision process.

**RELEVANCE OF BEHAVIORAL FINDINGS TO PRESCRIPTIONS OF POLICIES**

Ceteris paribus, better predictions are likely to result from theories with more realistic assumptions. Policies should be tailored to influence actual as opposed to an assumed behavior. To quote Douglas North, “the uncritical acceptance of the rationality assumption is devastating for most of the issues confronting social scientists and is a major stumbling block in the path of future progress. The rationality assumption is not wrong, but such an acceptance forecloses a deeper understanding of the decision-making process in confronting the uncertainties of the complex world we have created” (North, 2005, p. 5). Thaler and Benartzi (2004, p. 167) suggest, “before writing a prescription one must know the symptoms of the disease being treated.” Indeed, many mistakes made that led to the recent financial crisis could have been avoided if the decision-making process would have been considered when policies were implemented.

One example is policies designed to attract FDIs – or some types of specific FDIs. Economic theory would have a clear and straightforward prescription: grant some type of tax exemption or reduction. The rationale is straightforward: if the rate of return on investment is low and the risks involved are very high, tax incentives may change the rate of return. However, my doctoral study showed that the granting of income tax exemptions is not an important factor in the foreign investment decision process. The reasons for this conclusion were detailed in Aharoni (1966a, pp. 234–242) and will not be repeated here.

Based on the behavioral findings, a much better use of taxpayers’ funds is to market the country (Aharoni, 1966b), to reduce perceived risk and create the decision to look abroad. The marketing program should acquaint the consumer with the product – in our case acquaint the investor with the foreign country. It should supply up-to-date, accurate, and adequate information and neutralize the basic apprehension of uncertainty. It should also suggest concrete projects for consideration and demonstrate the advantage to the firm of investing in these projects. Above all, the program
should be well integrated and should aid the investor throughout the decision process. The cost of investigation should be minimized – mainly by supply of relevant information and perhaps by sharing the investigation costs.

My ideas seem to have been ignored by IB scholars. The only study I unearthed on the same marketing theme is Wells and Mint (1990, revised 2000). These authors define promotional techniques to consist of those (a) providing information to potential investors; (b) creating an attractive image of the country as a place to invest; and (c) providing services to prospective investors. Both the original paper and the revised one appeared as Foreign Investment Advisory Service (FIAS) occasional papers – not in an academic journal. In the real world, many countries established investment promotion agencies to facilitate FDIs. Today there are 228 such agencies from 156 countries that are members of the World Association of Investment Promotion Agencies (WAIPA) established in 1995. These agencies directly aim at encouraging FDIs – generally inward FDIs, but in many cases also outward FDIs. The effectiveness of these agencies in attracting FDIs was studied by Morisset and Andrews-Johnson (2003) – again as a FIAS occasional paper.

Many more examples of policy prescriptions may be cited from behavioral economics that the proposed design of institutions would help people make better choices. As one example, Shefrin and Thaler (1988) portray the life cycle of savings as different as classical economic theory. They take account of households’ lack of self-control and procrastination (tendency to postpone unpleasant tasks).

Procrastination, in turn, produces a status quo bias. Samuelson and Zeckhauser (1988) found that the median number of changes made by TIAA-CREF participants in the asset allocation over the lifetime was zero. Since then, several researchers studied retirement account portfolio behavior, relating it to various demographic variables and other participant characteristics such as age, gender, marital status, time in the 401(k) plan, salary, and time on the job (Agnew, Balduzzi, & Sundén, 2003). Of course, a policy that will achieve a desired result should take into account the behavioral elements. In the specific case of savings behavior, the elements are bounded rationality, self-control, procrastination and nominal loss aversion. Based on consideration of these elements, a plan was designed to increase savings rates, recognizing that households may lack the self-control to reduce current consumption in favor of future consumption (Thaler & Shefrin, 1981). The plan allows workers to commit themselves now to increase their savings rate each time they get a pay increase in the future (Thaler & Benartzi, 2004).
Recognizing that decisions are driven by emotions, Sunstein and Thaler endorse what they term libertarian paternalism, claiming it is not an oxymoron. Sunstein and Thaler state that “the libertarian aspect of our strategies lies in the straightforward insistence that, in general, people should be free to do what they like and to opt out of undesirable arrangements if they want to do so.” The paternalistic portion of the term “lies in the claim that it is legitimate for choice architects to try to influence people’s behavior in order to make their lives longer, healthier and better” (Sunstein & Thaler, 2008, p. 5). They use their notion of nudge within the context of choice architecture to propose policy recommendations that they believe are in the spirit of libertarian paternalism, in a variety of policy programs. They examine how people can be nudged into making better decisions for themselves on a range of issues, such as buying more healthy food or opting to save more. IB researchers up to now rarely offer such policies.

FUTURE RESEARCH IMPLICATIONS: WHAT ARE THE THINGS WE DO NOT KNOW AND HAVE TO STUDY?

We have shown that psychological aspects of decision making were largely ignored by IB researchers. Further, structured experiments are virtually unknown. Of course, a theory susceptible to mathematical measurement is much more elegant and may win applause for sound and profound thinking. However, as March points out, “variables that can be measured tend to be treated as more ‘real’ than those that cannot, even though the ones that cannot be measured may be more important” (March, 2006, pp. 203–204). It is quite unlikely that researchers ignored behavioral elements because they have considered them to be wrong or too deterministic. Therefore, IB theory should acknowledge heuristics and other aspects of bounded rationality, incorporate a theory of search, and include dynamic aspiration levels that would change with experience. It must also take account of the social and legal structures within which market transactions are carried out. Studies of actual cases of FDIs may also substantiate the salience of commitment to different stakeholders, including policymakers, accumulated during the investigation process. In fact, each of the areas discussed in IB literature offers ample opportunities for fruitful future research by using the insights gained by behavioral decision making and behavioral economics,
and applying them to different issues of international business. Several examples may be illustrative. Thus, a study of the trade-offs between competition and cooperation in networks should borrow from explanations of fairness. Note that many MNEs achieve competitive advantage by cooperation with other firms rather than by internalizing operations. Further, nonequity forms of FDI – e.g., subcontracting, management contracts, turnkey arrangements, franchising, licensing or product sharing, as well as different forms of strategic alliances – increased in importance, even if they are not recorded as FDI. In many service industries, nonequity forms are much more important than equity investments. In professional services, the ownership advantage of the firm is reflected in intangible assets such as reputation or organizational capabilities, information processing or managerial skills, and knowledge (Aharoni, 2000b). For very different reasons, airlines are globalizers that are not allowed to globalize. Inward FDI in airlines has been constrained by ownership requirements in bilateral Air Service Agreements (ASAs). They therefore are forced to use various forms of strategic alliances to augment international competitiveness (see Aharoni, 2002, 2004).4 These developments affect any discussion of modes of entry: the choice is not only about the degree of ownership but also about cooperation with independent firms. Cultural differences may also affect entry mode choices (Schneider & DeMeyer, 1991). For example, Japanese managers tend to prefer entry modes that allow higher control over technology (Bartlett & Ghoshal, 1989). Chinese TMTs are very different to their Western equivalents (Ping, 2007). “Born global” may be a result of managers’ experience and more knowledge about world affairs, cultural differences, and international operations in more countries of the world – not only a consequence of technological changes. Research should establish whether MNE managers exhibit greater variance in perceived uncertainty than their counterparts did 50 years ago.

One area of great importance is the ways to avoid inertia, given fast changes in the business environment and in technologies. How can an MNE keep its core capabilities dynamic and adjustable in the face of new technologies, different customers, and new suppliers? Behavioral theory is predominantly based on study of individuals and their behavior. Clearly, organizations are composed of individuals. Yet organizations might condition judgment even beyond any individual inefficiency.

The population of MNEs today is much more heterogeneous in a variety of aspects: home countries, their size, and their level of development as well as industries, the industry in which they operate, size of the firm, as well as years of experience as MNEs. Whether the behavior of such a diverse group
of firms is the same, or alternatively, different MNEs behave differently, it is an important area for future research. Behavioral economists claim that the behavior they unearthed (e.g., loss aversion) is a universal trait, true in all countries and in all cultures. IB researchers argue that since decision makers in MNEs come from different cultures, they make choices differently. Cultural differences are said to affect MNE strategies (e.g., Benito, 1997; Brouthers & Brouthers, 2001) and performance (e.g., Li & Guisinger, 1992; Park & Ungson, 1997). Furthermore, the role of environmental uncertainty for managers has been explicit in many studies on cultural distance (Barkema & Vermeulen, 1998). Shifting the focus from underlying country-level cultural indicators to indicators of managerial decision making may address some of the recent criticism of cultural distance research (e.g., Shenkar, 2001; Tihanyi, Griffith, & Russell, 2005). Managerial distance could capture variations in decision-making heuristics and biases across managers from different cultural traditions. Measuring how managers from different cultures perceive similar decisions could enhance upper echelon and governance research (see Aharoni, Tihanyi, & Connelly, 2010).

Second, even if the environmental conditions are identical, different decision mechanisms can produce different results. Therefore, one cannot assume that process-independent predictions would hold. In fact, these predictions may turn out to be totally wrong and misleading. Third, some firms attempted to become multinational and failed while other firms in the same industry or home country were very successful in their internationalization efforts. Some MNEs clearly perform better than others. Future research should identify the sources of variability in response to environmental conditions. Fourth, we know very little about the determinants of success in managing an MNE and integrating its activities across the globe or within a region. Ownership advantages eluded, as the reason for success is not easy to define. There is no real satisfactory explanation why some firms and industries became global while other firms in the same industry did not. Moreover, early research on the operation of MNEs has seen the primary task of the firm as tangible, repeated, measurable, and defined by the producer. All of these attributes are applicable neither to professional business service firms nor to many networks. Professional firms offer an intangible service, selling expertise that is generally customized and is based on a close interaction between the client and the supplier of the service, with little or no economies or scale of scope, and few possibilities of standardization. Networks are based on trust, not on hierarchy. In this
context, research that sheds light on what makes an MNE successful by focusing on the inner workings of the MNEs is badly needed.

Received IB explanations often ignore not only managerial decision making but also the ability to create a novel strategy and to invent new products. Of course, it is hard to avoid noticing that for a large number of MNEs the distinctive competence is based on innovation that created new markets – markets that did not exist, and thus the costs of conducting market transactions could not be compared to the costs of using internal hierarchies.

Certain managers of firms in small countries decide to make the firm; they lead a global firm to avoid the restrictions of growth from a small market base. Small firms sometimes enter international markets immediately upon inception, producing highly specialized goods for niche markets (Knight & Cavusgil, 1996, 2004). A strategy, after all, must be unique. It “must be predicated on building, maintaining and defending a competitive advantage” (Aharoni, 1993, p. 45). Clearly it is easier to study a large population by mathematical manipulation of a database than to follow trajectories of a unique strategy. Bandwagon behavior explains some foreign investment decisions but certainly not all, or even most of them. Outliers adopt more proactive routes toward globalization by the innovation of a new path. Strategies of firms are very heterogeneous and such differences cannot be explained by economic models (or, for that matter, by population ecology explanations) (Hannan & Freeman, 1977, 1984). Further, different managers may lead the same firm in similar environmental conditions to different strategies and to different locations around the globe.

Most past research on MNEs from Vernon (1971) to Rugman (2005) concentrated on the giant firms. Yet, there are about 80,000 MNEs, most of which are small and medium sized. We should learn about these firms at least to find out if they face different problems and obstacles in the path toward globalization of operations. We should also learn about the working of MNEs from small countries – in which the firm is a significant part of the GNP and thus may have a much too strong political, not only economic, clout (Aharoni, 2000a). It is true that the largest MNEs account for 90% of the world’s FDI stock. Yet IB theory must also be able to explain internationalization of small firms and of firms from small economies, which present different challenges compared to large economies (Aharoni, 1994). Perhaps one can learn from outliers more than from a study of averages and populations.
Several researchers have demonstrated the existence of a home bias in portfolio selection (French & Poterba, 1991; Tesar & Werner, 1995). Despite the well documented gains and reduced risk from international diversification, investors overwhelmingly prefer investments in domestic firms and in firms whose headquarters is in their country of residence (Coval & Moskowitz, 1999). Researchers also unearthed home bias in trade – preferring trade with neighbor countries, or even states (McCallum, 1995; Wolf, 2000). Several explanations were offered for the home bias, from an emphasis on barriers, to international movements, to preference of geographic proximity and amplification of information asymmetries between countries. All of the explanations seem quite inadequate, given the globalization of capital. Research is badly needed on behavior that causes home bias and to prescribe how a home bias could be eliminated or reduced.

In the specific area of top management, past research has focused on two dimensions of TMT characteristics: TMT demographics and heterogeneity of the team (Tihanyi, Ellstrand, Daily, & Dalton, 2001). TMT heterogeneity refers to the differences among team members in demographics and important cognitive aspects, values, and experiences. Hambrick and Mason (1984) assumed that heterogeneous TMT can obtain information from different sources and different opinions on the problem from team members. This difference in opinions would allow the TMT to make high-quality decisions and improve problem solving. Diversity provides a TMT with a range of different viewpoints and causes a cohesive team to be more receptive to the need for change (Hambrick & Mason, 1984). On the other hand, diversity reduces team cohesion and increased miscommunications, thereby leading to slower pace of strategic change (Hambrick & Mason, 1984). However, while greater homogeneity leads to faster decision making, it may also lead to insular thinking, and therefore, to strategic persistence in conditions when strategic change is appropriate. There is a lack of agreement among academia as to whether heterogeneous or homogeneous TMT is better for firm performance (Amason, 1996; Amason & Sapienza, 1997; Boone & Hendriks, 2009). Moreover, the contexts and dynamics of TMT vary across countries (Glunk et al., 2001). Therefore, the impact on the performance of the firm may be different in different cultures. Cultural differences affect the attitudes, values and faith of managers (Ronen & Shenkar, 1985), thereby influencing their strategy selection. Further, a study of TMT heterogeneity should take account of the impact of social context in which team members are embedded (Rau, 2008; Ping, 2007).
CONCLUSIONS: BEHAVIORAL ELEMENTS WERE IGNORED IN THE PAST AND THE PRESENT; HOPEFULLY THIS LACUNA WILL BE CORRECTED IN THE FUTURE

International business research has become more rigorous over the past 50 years, owing to developments in computing technology and statistical software and to a broader availability of international databases. Unfortunately, increased mathematical manipulation has often come at the cost of practical relevance. In their search for elegance and rigor, IB researchers ignored the rich evidence on psychological aspects of decision making, the complexity of decision making under uncertainty and the accumulation of commitments. In most studies, outcomes are deterministic, the firm is treated as a black box, and managers – if they are mentioned at all – are assumed to be rational calculators of costs and benefits. To be sure, certain differences among firms originating from different nations (and therefore cultures) are acknowledged.

The study of decision making in MNEs should take into account the many insights from a long line of research in behavioral decision making. It should also determine what is universally applicable and what is specific – to a culture, country, industry, size of firm, or other variables. This paper presented a large compilation of demonstrations from experimental data showing framing effects, hyperbolic discounting of intertemporal choice, endowment effect, fairness, and other circumstances under which rationality as defined by classical economists does not hold. It is hoped that these demonstrations will motivate and inspire young researchers to look for applications for IB theories. It is further hoped that researchers would acknowledge the limitations of the rational choice model. They should incorporate in their models the impact of overconfidence in judgments, the reading of information in self-serving manner, the sensitivity of decision makers to context and their myopic behavior when decisions are made. They should recognize the tendency to use heuristics and to display systematic biases – and clearly identify what they are. In studying social responsibility in home and host countries they should identify the social norms and the definition of managers use for equity and fairness. They should further propose policies that take into account these and other behavioral elements and ways to remedy the tendency to overvalue information because it is readily available or perhaps show how to make relevant information readily available. The list of needed amendments to the theory is quite long.
Hopefully, future researchers would quickly and professionally do the desired work.

NOTES

2. One exception is the structured experiment carried out by Buckley, Devinney, and Louviere (2007). In this experiment the roles of information, biases, and managerial experience was very different in two phases of an FDI investment decision process. The first (“consider”) stage is a choice of potential investment options. The second (“invest”) stage is the actual choice of the investment. Managers employed more rational measures, including return ratios, cost measures, and market conditions. In the investment-choice phase, however, managers focused more on FDI experience and host country specific factors, such as the political environment and language.
3. Langlois and Csontos (1993, p. 118) argue that behaviorists portray agents as hardheaded rule followers or preprogrammed satisfiers. These agents act in a deterministic way.
4. The number of airlines alliances has risen markedly from around 20 in the early 1990s to a total of 1,221 by 2001 (UNCTAD, 2004).

REFERENCES


Behavioral Elements in Foreign Direct Investments


**RESEARCH ARTICLE**

EXPLORING THE ROLE OF MANAGERIAL INTENTIONALITY IN INTERNATIONAL BUSINESS

Thomas Hutzschenreuter, Un-Seok Han and Ingo Kleindienst

ABSTRACT

Managerial intentionality has been assumed to be the most differentiating, but also the most neglected factor influencing internationalization. Although various scholars have emphasized its relevance, the key question still remains unanswered: What is managerial intentionality and why and how does it matter? Researchers share the view that internationalization paths are a joint outcome of environmental factors, path dependence and learning, and managerial intentionality. However, although managerial intentionality is argued to be an important factor, it is rather taken as a “given.” Therefore, we step back and take a closer look at its very nature and relevance for international business research.

INTRODUCTION

Herzogenaurach, Germany, July 1, 1924: the brothers Adolf and Rudolf Dassler launch their company Gebrüder Dassler, Sportschuhsfabrik,
Herzogenaurach, dedicated to the invention and production of modern sports shoes. Despite the disadvantageous economic environment in post-World War I created by the harsh prescriptions of the Versailles Treaty, the company soon benefits from sports and other forms of entertainment beginning to attract swelling crowds. Until World War II, the company prospers and even becomes the official equipment supplier of Germany’s Olympic team. During World War II, however, the differences between the brothers were exacerbated. By 1948, the rift leads Adolf and Rudolf to split up their company, enabling the subsequent launch of their own companies. In 1948, Rudolf launches his new company, Puma, while Adolf launches his company, Adidas, in early 1949. Competing fiercely in the market for sports shoes, and sports equipment more generally, both companies benefit greatly from the rise of sports as an important economic sector in the 1950s and 1960s (Smit, 2008). To ensure future growth, both companies internationalize. Adidas begins its internationalization with exports to Switzerland, Scandinavia, and Canada in 1950, and exports to 40 different nations by 1955. The first foreign subsidiary, however, is founded in 1958 in Canada, followed by a subsidiary in France in 1959, and one in South Africa in 1972 (Adidas, Personal correspondence with Dr. Barbara Hölschen, Manager Archive and Museum History Management, 2009; Smit, 2008). In contrast, Puma’s internationalization starts with a subsidiary in Austria in 1964, followed by a subsidiary in France in 1967. In 1978 and 1979, Puma launches subsidiaries in Hong Kong and United States, respectively (Puma, 1986).

The examples of Adidas and Puma depict two companies that exhibit nearly identical founding conditions, such as place of origin (both headquarters are located within a distance of less than 3 miles), product portfolio (both companies focus on sports equipment, in particular sports shoes), or firm size (the joint company was equally divided between Adolf and Rudolf). Hence, considering the similarities between Adidas and Puma and following leading internationalization theories, one should have expected a similar or almost identical internationalization process for both companies. For example, following the theoretical reasoning of Johanson and Vahlne’s (1977) internationalization model, firms internationalize in an incremental manner from less distant countries to more distant countries. Further extending their model, Johanson and Vahlne (2009) argue that internationalization is the outcome of firms’ actions to strengthen their position in a given business network. Accordingly, since Adidas and Puma are located within the same German town, both are facing identical distances to potential host countries. In addition, it is likely that there was a
relatively high overlap between the business networks of the two companies, at least at the beginning, as they originated in the same predecessor firm. Nevertheless, while Puma established its first foreign subsidiary in Austria, Adidas chose to cross the North Atlantic Ocean to open its first foreign subsidiary in Canada. Likewise, the subsequent expansion steps of Adidas and Puma differ significantly. Furthermore, while Adidas undertook cross-border steps in a very early stage, Puma began its internationalization relatively late. Hence, a question arises as to why two nearly identical companies chose to take entirely different paths of internationalization. This question becomes even more interesting when the similarities between the founders, Adolf and Rudolf Dassler, are considered. Being born only two years apart, both brothers were raised in the same manner, in the same location, gained the same experience, and worked together in the same company for over two decades. Hence, any explanation being based on differences in demographic variables seems unpromising.

Taken together, the anecdotal evidence presented above raises questions that cannot be answered with traditional internationalization theory, such as why do some firms internationalize in a more rapid way, while other firms expand rather gradually (Maitland, Rose, & Nicholas, 2005)? Why do some firms undertake cross-border steps early on or are even international from inception (Oviatt & McDougall, 1994), while other firms internationalize relatively late; that is, when in a mature stage? Put more generally, the core question is: why does heterogeneity exist among firms with regard to the various aspects of their international activities and how can we explain it?

Managerial Intentionality: A Missing Link in International Business Theory

International business research provides many fruitful attempts, both theoretical and empirical, to explore and explain the phenomenon of internationalization and, accordingly, multinationality. In a bibliometric analysis of the field of internationalization research, Hutzschenreuter, Pedersen, and Volberda (2007) note that the international business literature has paid far more attention to incremental, gradual, experience-, and knowledge-based aspects of internationalization, theoretically underpinned by approaches such as the internalization theory (Buckley & Casson, 1976; Hennart, 1982), the eclectic paradigm (Dunning, 1980, 1988), and the knowledge-based view (Kogut & Zander, 1993). Simultaneously, the role of strategic intent, entrepreneurship, and other aspects of managerial decision
making is hardly recognized by these approaches. There are few exceptions of studies that explicitly deal with aspects concerning the role of management. For example, Buckley, Devinney, and Louviere (2007) examine foreign direct investment choices with a clear focus on the decision-making process and the managers involved, using structured experimentation. They show that the consideration of investments follows rational rules, but that the choice of actual investments deviates from explanatory approaches provided by traditional models such as the rationalist theory or the internalization theory.

In addition, the spotlight is also more likely to be thrown on content-related aspects of international business (e.g., entry mode, timing, liabilities of foreignness) than on the underlying decision making and the managers involved, in particular their managerial intentionality. In this chapter, we therefore seek to shed light on the role of managerial intentionality in the international business context. Managerial intentionality thereby describes the volitional dimension of managerial behavior and “may not only be the most differentiating, but also the most neglected factor that influences internationalization and, logically, multinationality.” (Hutzschenreuter et al., 2007, p. 1058).

The next section briefly reviews leading theories of international business and discusses the role managers play, in particular with regard to managerial intentionality. Following this, we outline the concept of managerial intentionality as a theoretical frame of reference to discuss the phenomenon of international business. We note that managerial intentionality should be seen as a complementary approach to the existing research, focusing on the role of managers. In addition, we also take into account international business research that explicitly deals with managers or the “human factor,” and differentiate between the concept of managerial intentionality and related concepts, such as global mindset or cultural intelligence. On the basis of the discussion, we then give some suggestions for further research on managerial intentionality in international business.

To conclude, we summarize the insights of our contribution.

INTERNATIONAL BUSINESS AND THE CONCEPT OF MANAGERIAL INTENTIONALITY

Why do multinational enterprises (MNEs) exist and how do they internationalize? This topic has attracted the attention of scholars for the
past more than 50 years. Thus, while addressing these questions, various research streams from different perspectives have arisen that deal with the phenomenon of MNE and international expansion.

In his seminal study on the international operations of national firms, Stephen Hymer (1960) focused on the firm as a proper unit of analysis to examine internationalization. According to Hymer, firms make foreign direct investments to gain control over foreign assets that allow them to better influence the business activities in the respective country and to possibly reduce the competition. Furthermore, corporations can possess firm-specific advantages that are deployed in other countries to overcome barriers to international operations. Hymer's ideas have been followed up by other international business researchers (e.g., Caves, 1971; Kindleberger, 1969), who also emphasize the relevance of market barriers and firm-specific advantages. The role of management is not explicitly discussed in this research stream, but rather arises in terms of normative implications that say managers have to identify the firm-specific advantages and deploy them in the foreign markets. Furthermore, the argument of existing firm-specific advantages as drivers of international activities omits that managerial intentionality could also target the creation of new firm-specific advantages, for example, by gaining access to resources or exploiting local skills in foreign countries.

Internalization theory forms another research tradition that aims at explaining the phenomenon of internationalization and that is developed and refined by various distinguished scholars (e.g., Buckley & Casson, 1976; Hennart, 1982; Rugman, 1980; Teece, 1986). The leading question addressed by this theory is “under what conditions should the interdependent activities be coordinated by the management of a firm rather than externally by market forces?” (Buckley & Casson, 1976, p. 36). Referring to transaction costs-theoretical arguments (Coase, 1937; Williamson, 1975, 1985), this approach characterizes internationalization steps as the consequence of an assessment of market transactions costs vs. costs that arises in using the internal hierarchy of firms. Thus, MNEs and their international growth can be interpreted as the outcome of internalization across national borders. According to Buckley (1993, p. 199), the role of management is confined to the “sequential identification, exploitation and creation of profitable market imperfections as opportunities for growth.” Simultaneously, he admits that this narrow view does not fully account for the role of management. In the light of a managerial intentionality view, the internalization approach does not explain so much why managers actually decide to undertake internationalization steps, but rather defines conditions under which transactions
across borders should be internalized. Related to this argument is the emerging question of whether or not managers solely act based on cost efficiency as postulated by this theory.

Seeking an explanation of internationalization and international production, John Dunning (1977, 1979, 1980) developed an approach that incorporated arguments of various other approaches, such as the internalization theory and the theory of monopolistic advantages, into an eclectic paradigm of international production. This approach was an attempt by Dunning to provide a holistic framework explaining international activities, and was promoted by various scholars in the field of international business research (e.g., Cantwell & Narula, 2003; Corley, 1992; Devinney, 2004). At the heart of the eclectic paradigm are three types of advantages: ownership advantages, location advantages, and internalization advantages. Based on these advantage concepts, conditions are described that lead to effective market entry modes matching the mixture of advantages exploited. As the eclectic paradigm consists of arguments brought forward by the approaches reviewed earlier, the assessment of the role of management and managerial intentionality is similar. Managers have to evaluate the (non)existence of the different advantage types, and then decide on the respective internationalization mode. Deviations from the prescriptive scheme are not accounted for. For example, what could be the managerial intentionality to simultaneously enter the same host country with different entry modes? Furthermore, why do firms use certain entry modes lacking the necessary advantage(s); for example, undertaking a cross-border step into a country where it lacks location advantages?

Whereas the aforementioned research streams were originally founded on economic principles – market imperfections, barriers of competition, and transaction costs – and approach the phenomenon of internationalization in a fairly static manner, the so-called Uppsala school focuses primarily on the dynamics of international activities. Their arguments are based on a behavior-theoretical grounding (e.g., Aharoni, 1966; Cyert & March, 1963), giving more account to certain characteristics of managers, such as bounded rationality or uncertainty avoidance. In their seminal article, Jan Johanson and Jan-Erik Vahlne (1977) developed a model of internationalization process incorporating findings from previous empirical research (e.g., Johanson & Wiedersheim-Paul, 1975). Two patterns – the psychic distance and the establishment chain – are assumed to lead to a more incremental process of international activities within and across host countries. The concept of psychic distance refers to the internationalization across different foreign markets, where firms are assumed to first enter countries that are
closer in terms of culture, language, or business practices, followed by cross-border forays into more distant countries. The concept of the establishment chain is related to the internationalization process within a certain host country assuming an increase of resources and commitment. Firms thereby start with sporadic export activities and increase their commitment over time by undertaking more resource-intensive activities in terms of establishing sales subsidiaries and production facilities. The determining factor to these patterns is market knowledge, which plays a key role in the internationalization process as it both limits and enables the cross-border movement of firms. According to this approach, managers are carriers of the knowledge that they gain while working in a host country. Simultaneously, they have no discretion to make voluntary internationalization decisions as these are determined by the knowledge. Various empirical studies have shown that firms do not necessarily follow the pattern proposed by the Uppsala theory (Hedlund & Kverneland, 1985; Sullivan & Bauerschmidt, 1990). This opens an opportunity to ask how managerial intentionality explains these deviations and why firms break out of the predicted patterns by entering more distant countries or by immediately establishing a manufacturing facility. Revisiting their internationalization model, Johanson and Vahlne (2009) extend it by incorporating the business networks firms are positioned within. By characterizing managers as “carriers of (tacit) knowledge, trust, commitment, and network relations” (Johanson & Vahlne, 2009, p. 13), they focus on the “assets” of managers that determine internationalization activities rather than on why a manager decides on a specific cross-border step and a certain international path.

As knowledge plays a central role in the Uppsala approach, it also does so in the approach developed by Kogut and Zander (1993). According to Kogut and Zander, the MNE is a repository of knowledge and an efficient mechanism to create and internally transfer this knowledge. In this context, internationalization activities can be explained by the transfer of knowledge. The entry mode – for example, via wholly owned subsidiary, joint venture, or licensing – depends on the codifiability, the teachability, and the complexity of the respective knowledge. In the knowledge-based view, the MNE is seen as a social community “in which through repeated interactions, individuals and groups […] develop an understanding by which to transfer knowledge from ideas into production markets.” (Kogut & Zander, 1993, p. 631). Thus, managers are seen as knowledge creators and transmitters that are able to use that knowledge for international growth opportunities. However, the knowledge-based approach focuses on the capability side, that is, the creating and transferring of
knowledge, rather than the volitional managerial dimension of internationalization decisions.

To summarize, various research streams approach the phenomenon of international business from different perspectives using different explanatory variables, putting different degrees of emphasis on the role of management (see Table 1). Whereas the economics-based approaches – the theory of monopolistic advantages, the internalization theory, and the eclectic paradigm – hardly recognize the influence of managers, the Uppsala school and the knowledge-based view explicitly account for managers as carriers of knowledge decisive for cross-border expansion. Simultaneously, Johanson and Vahlne (1977, 2009) as well as Kogut and Zander (1993) primarily focus on what enables internationalization, that is, the capability side of managerial impact. In addition, all these research streams fail to account for the relevance of managerial intentionality; that is, what managers actually want. The “devaluation” of managerial intentionality, and the role of management in general, might be explained by reference to the historic origin of the base research traditions that underlie these theories, where the “human factor” is deterministic, with little opportunity for discretion. Another reason is conceptual in nature. The application of a certain theoretical lens automatically leads to a deterministic view on the phenomenon from a specific angle. In this context, managerial intentionality is ex ante determined by a predefined theoretical argument, and deviations from hypothesized relationships might be explained by randomness. We argue that managerial intentionality provides a fruitful complementary approach for international business in that it can be used to inquire such deviations better taking into account the idiosyncratic nature of the phenomenon. Thereby, we rely on the argument that firms “comprise behaviors directly attributable to human intentionality” (McKelvey, 1997, p. 357).

**Intentionality**

The concept of intentionality has been widely discussed in the fields of philosophy and psychology. It is generally described as a state of mind in which activity is directed toward something – that is, purposiveness – or is about something – that is, aboutness (e.g., Anscombe, 1957; Binkley, Bronaugh, & Marras, 1971; Bratman, 1987; Brentano, 1874/1973; Fishbein & Ajzen, 1975; Heckhausen, 1991; Husserl, 1913/1983; Lyons, 1995; Malle, Moses, & Baldwin, 2001; Ryan, 1970; Searle, 1983). To emphasize the
<table>
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<tr>
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<td>Theory of monopolistic advantage (Hymer, 1960)</td>
<td>Firms/ownership and monopolistic advantage</td>
<td>Companies internationalize to gain control of foreign assets and to deploy their specific advantages in the foreign markets</td>
<td>Passive; managers are seeking for market opportunities with regard to the advantages the firm possesses</td>
</tr>
<tr>
<td>Internalization theory (Buckley &amp; Casson, 1976; Hennart, 1982; Rugman, 1980; Teece, 1986)</td>
<td>Firms/transaction costs</td>
<td>Cross-border steps occur if the market transactions costs are higher than the costs for using the internal hierarchy of the firm</td>
<td>Passive; managers are to trade off the costs of both transactions via the market or internalized through the firm</td>
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<td>Eclectic paradigm (Dunning, 1977, 1979, 1980)</td>
<td>Firms/ownership (O)-, location (L)-, and internalization (I)-advantages</td>
<td>The (non)possession of the OLI-advantages determines whether and how firms internationalize</td>
<td>Passive; managers assess the different advantage types and decide on the entry mode of internationalization based on the preceding assessment</td>
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<td>Internationalization process theory (Johanson &amp; Vahlne, 1977, 2009)</td>
<td>Firms/learning and knowledge</td>
<td>The incremental internationalization process within and across countries depends on the market knowledge gained by the firm through business activities</td>
<td>Passive; managers as carriers of knowledge, trust, commitment, and network relations</td>
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<tr>
<td>Knowledge-based view of the MNC (Kogut &amp; Zander, 1993)</td>
<td>Firms/knowledge transfer</td>
<td>Internationalization activities take place due to the transfer of knowledge whereby the mode depends on the codifiability, teachability, and complexity of the respective knowledge</td>
<td>Passive; managers as parts of a social community and knowledge creators and transmitters</td>
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action-related quality of intentionality, we limit the discussion that follows to the meaning of purposiveness or goal-directedness.

Intentionality is a core feature of human agency as “to be an agent is to intentionally make things happen by one’s actions” (Bandura, 2001, p. 2). The notion of intentionality and intention, that is, a concrete mental representation in terms of content, is used in various models that deal with reasoned action of agents. For example, in the “Theory of Planned Behavior” developed by Ajzen (1991), attitudes, subjective norms, and perceived behavioral control are argued to predict behavioral intentions. These intentions in turn are seen as the immediate antecedent of a certain behavior. On the basis of these theoretical underpinnings, numerous empirical studies have been performed that subject different intentions to scrutiny; for example, the behavioral intention to use an information system (Jackson, Chow, & Leitch, 1997), the intentions toward purchasing genetically modified food (Cook, Kerr, & Moore, 2002), or intentions directed toward the purchase of computers (McQuarrie & Langmeyer, 1987).

In the management literature, the notion of intentionality is especially prominent in the study of entrepreneurship. According to Bird (1988), intentionality as a precursor of actions is framed by both rational, analytic, and cause- and effect-oriented process of the entrepreneur, as well as the intuitive, holistic, and contextual thinking. Boyd and Vozikis (1994) extend Bird’s model integrating the concept of self-efficacy to take into account constraints that may exist while pursuing entrepreneurial intentions. Besides the entrepreneurship research, intentions have also been taken in the field of organizational commitment research to analyze the turnover behavior of employees (e.g., George & Jones, 1996; Mitchel, 1981; Stumpf & Hartman, 1984; van Breukelen, van der Vlist, & Steensma, 2004). In organizational research, the coevolutionary approach makes intentionality a subject of the discussion, where it represents the influence of managers on the organizational development (e.g., Flier, Van Den Bosch, & Volberda, 2003; Lewin & Volberda, 1999; Lewin, Long, & Carroll, 1999). Yet, what intentionality comprises is left open.

In summary, the concept of intentionality is assumed to be directly linked to behavior that can range from ordinary actions in everyday life to rather complex actions such as undertaking a new venture. Given this understanding of intentionality as an action-guiding concept, two instrumental features of intentionality can be derived: (1) with regard to the individual, intentionality expresses the inherent quality of the mind to be directed at objects or goals, thus allowing the individual to act purposively and (2) concerning collective systems of individuals, intentionality exhibits a
social function in that people, who directly interact with each other, can distinguish between intentional and unintentional actions. This distinction is important for mutual judgments that set the course of social interactions. In this context, Malle and Knobe (1997, pp. 101–102) illustrate: “If considered intentional, a critical remark can be seen as a hurtful insult; a collision in the hallway, as a dangerous provocation; and a charming smile, as a hint of seduction. But if considered unintentional, that same remark may be excused; the same collision leads to a new friendship; and the same smile might simply indicate a good mood.”

Managerial Intentionality

When we talk about intentionality and managerial intentionality we assume that managers are able to act voluntarily. In addition, we see intentionality as a necessary property for managers to come to decisions, especially in the face of uncertainty and bounded rationality (Simon, 1947). Against the backdrop of the discussion of whether managers matter, the so-called voluntarism–determinism debate, intentionality is somehow taken as the pole of the voluntaristic view. Although we define intentionality as the volitional dimension of behavior, tending to a voluntaristic position, we also consider the fact that managers are embedded in a specific environmental setting and constrained by certain organizational and institutional “givens.” Thus, we attribute to managers what Hambrick and Finkelstein (1987) call “managerial discretion,” a certain latitude of action in which managers can voluntarily act. Furthermore, although we elaborate intentionality as a concept that refers to conscious reasoning, we do not deny or play down the role of subconscious cognitive processes.

In the remarks made above, intentionality is described in a very broad sense, referring to human beings in general. For our purpose, we use the term “managerial intentionality.” As it semantically indicates, managerial intentionality is a specific form of intentionality referring to the reality and the role of managers. This specification serves to emphasize the difference between managerial intentionality and other types of intentionality; for example, the intentionality of parents or the intentionality of politicians. Thus, the distinguishing characteristics are the person and the relevant role s/he possesses. The attribute “managerial” is associated with the notion that managers are embedded and acting in a business-specific context with a certain task environment, corresponding stakeholders, and certain requirements to work. Another function of specifying the type of intentionality is to
allocate our attention to certain intentions; in our case, intentions concern the international business activities of firms.

We conceptualize managerial intentionality based on three different mental states – desire, belief, and intention – that can lead to a certain action. According to Michael E. Bratman (1987, p. 6), “the idea what makes it true that an action was performed intentionally, or with a certain intention, are just facts about the relation of that action to what the agent desires and what the agent believes.” In other words, the formation and commitment of a certain intention depends on a certain desire–belief combination. Malle and Knobe (1997, p. 108) argue in a similar way: “The presence of an intention to act implies, however, both a desire for an outcome and a belief that the intended act will lead to that outcome.” For example, the intention of a CEO of an MNE to enter a new regional market is based on the desire to extend the geographical scope of the company and the belief about the consequences of the new market entry, as well as the belief about the firm’s ability to put it into action.

The mental state of desire describes the motivational dimension of managerial intentionality. Desire is at first a very broad term comprising numerous types, for example, physiological desires originating from basic needs such as hunger or thirst. For our purpose, we define desire in a general sense as a state of affairs managers deliberately want to bring about. Beliefs are fed by the knowledge the manager believes is true in the circumstances. For example, a manager that plans a cross-border step might believe that the company possesses enough financial and human resources to implement the step and that the institutional setting in the target country is adequate for the business activities. In this context, beliefs reflect assumptions about the feasibility of carrying out certain desired actions (e.g., Devinney, Midgley, & Venaik, 2000, 2003). Yet, as s/he is characterized by a limited information-processing capacity and a biased perception, beliefs might be incomplete or incorrect (Dearborn & Simon, 1958; Walsh, 1988). The central mental state, intention, links the two aforementioned mental states to action. Contrary to desires that are rather potential influencers of action, intentions are conduct-controlling proattitudes, that is, intentions are characterized by a specific commitment to the planned action (Bratman, 1987). Furthermore, intention also differs from goal in that “the successful attainment of a goal is contingent on the outcome of action, whereas intention initiates, maintains, and directs the activity.” (Chapman, 2001, p. 815). Although managerial intentionality is a psychological concept referring to the “inner states” of a manager, it is not isolated, as managers are embedded in “outer states” of environmental context (see Fig. 1).
This environmental context contains the organizational and industrial settings, as well as the cultural and institutional settings. By acting and learning in these environmental settings, managers can gain new information, which leads to changes of their managerial intentionality, that is, their desires, beliefs, and consistently, intentions.

In a functional manner, managerial intentionality serves as precursor to future-directed action. A given managerial intentionality controls the behavior with regard to the intention formed. Activities are aligned to consistency with the pursued goal. Furthermore, resources are reviewed and, more generally, attention is allocated toward issues that managers hold important for goal achievement. Hence, managerial intentionality as goal-directedness is future-oriented by definition. Accordingly, managers conceive of a future state of affairs they want to create. In this regard, managerial intentionality operates as kind of a bridge that links future and present by sustaining temporal tension (Bird, 1988, p. 445). In a sense, it creates a certain stability or inertia that preserves against permanent reconsideration of one’s plans. Otherwise, goals would never be achieved and managers would act ignes fatui, completely aimlessly.

**How Does Managerial Intentionality Differ from Related Concepts?**

In the international business literature, various concepts also refer to managerial characteristics that are cognitive in nature. For example, the
concept of the global mindset is related to the cognitive structure of managers (e.g., Gupta & Govindarajan, 2002; Kedia & Mukherji, 1999; Levy, Beechler, Taylor, & Boyacigiller, 2007; Murtha, Lenway, & Bagozzi, 1998; Rhinesmith, 1992). The notion of a global mindset emerges in the early work of Perlmutter (1969) and Bartlett and Ghoshal (1989) who propose various archetypes that are characterized by certain cognitive orientations or mindset of the respective managers. Levy et al. (2007, p. 244) define global mindset as “highly complex cognitive structure characterized by an openness to, and articulation of multiple cultural and strategic realities on both global and local levels, and the cognitive ability to mediate and integrate across this multiplicity.” Their framework is based on the information-processing theory in which action is explained as the result of preceding information acquisition and interpretation activities.

Closely linked to the global mindset is the concept of cultural intelligence (Earley, Murnieks, & Mosakowski, 2007; Early, 2002; Thomas & Inkson, 2004). Cultural intelligence refers to the individual capability to effectively adapt to new cultural settings. Both concepts – global mindset and cultural intelligence – focus on capability-related aspects. Managers with a global mindset and better cultural intelligence are assumed to work more effectively in international and cross-cultural settings and make more effective global strategies. This can be compared to the concept of managerial intentionality, where the emphasis is on the volitional dimension of managerial action, what managers want to do instead of what they are able to do. Put in other words: while the concept of global mindset and cultural intelligence ask how executives could effectively design and implement strategies with regard to the geographical scope of the firm, managerial intentionality refers to the question of why managers are changing the global strategy of the firm. However, we can also see that all of these concepts are complementary in that they refer to the “mind of managers” emphasizing different aspects of the mind. The combination of all of them could provide fruitful new insights as a specific mindset might facilitate the formation of certain managerial intentions with regard to the international business activities of a firm.

**RESEARCH AGENDA**

We have introduced managerial intentionality in the international business context as a concept that can capture the volitional dimension of managerial behavior, providing a framework to help explain the internationalization
activities of firms as outcomes of managerial decisions. In what follows, we propose various areas for further research with important issues to be addressed to further elaborate our understanding of managerial intentionality and international business.

We conceptualized managerial intentionality as the interplay of the three mental states: desire, belief, and intention. In this regard, further research should focus on the different desires, beliefs, and intentions that managers hold in an international business context. While a considerable amount of research has been dedicated to managers’ beliefs (e.g., Markóczy, 2000; Ping Ping et al., 2004; Robertson, Al-khatib, Al-habib, & Lanoue, 2001; Swee Hoon, 2000), there are few studies that explicitly deal with the desires and intentions of managers in the international business context. For example, the internationalization process of firms is ascribed to predefined intentional categories such as “resource-seeking” or “market-seeking.” Thus, an evaluation of the actual managerial intentions is left behind. In this regard, researchers could use a more “fine-grained” approach (Harrigan, 1983) for exploring managerial intentionality. In-depth case analyses might help to capture the volitional dimension through verbal and written reports or personal interviews. Such an approach acknowledges the close relation between intentionality and language (Glock, 2001) as managers can express their intentionality by using phrases such as “I believe . . .,” “I desire . . .,” or “I intend . . .” Another method to understand managerial intentionality is introspection, as “psychological concepts (e.g., desire, self-efficacy, purpose, satisfaction, and belief) could not even be formulated or grasped without introspection” (Locke & Latham, 2004, p. 397). We see this method as complementary to those that imply an external observer perspective.

In addition to the analysis of every single mental state constituting managerial intentionality, further research could also anchor on the relationships between concepts, in particular between desire and belief. We argued that belief, inter alia, based on knowledge the manager holds is true. One research question could be to what extent beliefs lead to certain desires? On the other hand, one could also ask whether certain desires influence the formation of new beliefs and knowledge.

Against the backdrop of increasing research on emotion – the affective part of human behavior – in international business and its importance in decision making (e.g., van de Laar & de Neubourg, 2006), research efforts could inquire into the relationship between emotions and managerial intentionality. These efforts could be supported by insights and methods of neuroscience that help to analyze what actually happens in the brain of
managers. In this regard, Camerer, Loewenstein, and Prelec (2005, p. 53) state that “advances in neuroscience now make direct measurement of thoughts and feelings possible for the first time, opening the ‘black box’ which is the building block of any economic interaction and system – the human mind.” By using different instruments such as positron emission topography, functional magnetic resonance imaging (fMRI), or diffusion tensor imaging (DTI), researchers could track which parts of the brain are activated while managers solve certain problems. As parts of the brain are, to a certain extent, related to affective and therefore subconscious processes while other parts are assigned to rather cognitive processes, neuroscientific methods might help to capture subconscious processes that are involved in the managerial decision-making process.

Managers are embedded in a certain environmental context in terms of different institutional, cultural, and socioeconomic settings. Thus, further research could go into the matter whether differences in managerial intentionality exist between managers with regard to their specific embeddedness. By doing so, the central role of culture in international business research should be taken into account while searching for possible patterns of managerial intentionality. In addition, one could seek out the differences in managerial intentionality between decision-makers of firms originating in emerging economies and those of firms in developed countries, thereby asking whether the “springboard perspective” of emerging market enterprises (Yadong & Tung, 2007) is grounded in a certain managerial intentionality.

Another important area of further research could focus on the temporal dimension of managerial intentionality – the dynamics of managerial intentionality. How do desires, beliefs, and intentions change over time? As time goes by, new opportunities might arise that lead to the formation of certain desires, or managers gain new experience that flows into reconsideration and change of beliefs. This is all the more interesting because the change of beliefs, given a certain desire, could form a concrete intention that did not exist before. Managers might consider a desire or goal achievable due to new knowledge.

We have assumed that managerial intentionality is primarily operating at the individual level. Future research could aim at investigating the relationship between individual managerial intentionality and collective managerial intentionality. In past research, concepts such as “dominant logic” (Bettis & Prahalad, 1995; Prahalad & Bettis, 1986) or “strategic intent” (Hamel & Prahalad, 1989) have emphasized the importance of the managerial mind in a collective setting. As firms represent complex
socioeconomic systems, the question of the existence and function of collective intentionality more or less naturally arises. For example, one could ask whether and how collective intentionality emerges and develops in the top management team of an MNE? Which factors are relevant to implement such a collective intentionality and what mechanisms managers can use to effectively establish a certain strategic intent on the organizational level?

As has been shown in the review section (pp. 116–120), the concept of managerial intentionality can provide a complementary hypothesis to more traditional approaches. For example, the findings of Rugman and Verbeke (2004) that many of the world’s largest firms are regionally based rather than global could be argued based on liabilities of foreignness referring to determination by external conditions. Conversely, managerial intentionality provides a complementary explanation that stresses regionalization as the result of managerial intentions. Thus, future research could use the managerial intentionality view to reconsider existing knowledge in international business research.

To summarize, the concept of managerial intentionality provides a broad spectrum for further research and a framework to analyze the phenomenon of international business from a more managerial perspective, where the starting point of reasoning is the manager’s mind. Although managerial intentionality can serve to capture the volitional dimension of managerial behavior based on its constituents, desire, belief, and intention, the origin of the volition by itself is beyond scope. Or to put it in other words: although managerial intentionality can give an answer to the question of what managers want, the question of why managers want what they want leaves space for rather philosophical discourses.

**CONCLUSION**

We opened this chapter asking why internationalization behavior of firms can differ. As we have seen, the main research streams of international business neglect the role of management or confine it to the capability side. Furthermore, the approaches basically disregard managerial intentionality and the discretionary characteristic of managerial decision making with regard to, for example, the changes of a firm’s geographical scope. We therefore outlined a concept of managerial intentionality that can provide a complementary approach to explain the phenomenon of international business with its various facets, especially deviations that
might not be captured by existing approaches. Thus, by bringing managerial intentionality to the fore we emphasize the role that managers play in the international business activities of firms in general. We conceptualized managerial intentionality as a quality of mind that is constituted by the three mental states: desire, belief, and intention.

Emphasizing the relevance of managerial intentionality does not deny the role of environmental aspects – such as organizational-, industry- or country-level related factors – but rather invite to the complementary consideration of an additional “human factor” in international business research. In this sense, we provide a link between international business research and international management research. We are convinced that there is a general need to increasingly shift more attention to the psychology of international business (research) and that the concept of managerial intentionality can contribute to provide one anchor point by opening the “black box” of managers’ minds.

NOTE

1. It is important to note that especially considering ethical and social issues, consumers are likely to indicate the importance of these issues but might not act according to their statements. As a consequence, traditional survey methods are likely to overstate the importance of ethical and social issues and will add unwanted variance into the measurement process. Accordingly, the classical reasoning from intention to behavior should be complemented with reasoning from behavior to intention and attitudes, respectively (Auger & Devinney, 2007; Devinney, Auger, & Eckhardt, 2010).

REFERENCES


THE PAST, PRESENT AND FUTURE OF MANAGING DISTANCE: STAKEHOLDERS AND DEVELOPMENT

Rob van Tulder

ABSTRACT

This paper explores whether and what kind of distance can be considered a relevant factor for managers of multinational enterprises (MNEs). In the so-called era of globalization, traditional measures such as geographical, cultural or psychic distance have become less relevant or surrounded by growing ambiguity. Instead, institutional distance, governance or administrative distance have been introduced as variables in understanding success or failure of MNEs. Relative institutional distance, thereby, proves more important than absolute distance. This paper argues that further advances in international management studies critically depend on whether it is possible to, first, move the study of internationalization from ‘factors’ to ‘actors’ and, secondly, add societal relevance to managerial relevance. Now and in the future, therefore, two final dimensions of distance are increasingly relevant: stakeholder distance and normative/development distance.
INTRODUCTION: DISTANCE AND ADVANCES IN INTERNATIONAL MANAGEMENT

In 1997, at the peak of the globalisation wave, Frances Cairncross, editor of the Economist, compellingly proclaimed the ‘death of distance’. She argued that the communication revolution would bring down communication costs to such an extent that distance would no longer be a relevant barrier for social and economic interaction (Cairncross, 1997). In contrast, others have argued that distance is and will remain an important factor for firms, even in a technologically connected and globalized world. According to Nachum and Zaheer, ‘[d]istance is fundamental in international business theory, and implicitly or explicitly occupies a central position in all its subfields’ (2005, p. 747). However, distance is a broad concept that consists of several dimensions. Ghemawat’s (2001) CAGE framework, for instance, distinguishes four basic dimensions of distance – cultural, administrative, geographic and economic – and suggests that firms operating across borders have to deal with each of these distance dimensions simultaneously. To what extent each of these distance dimensions prevails – as well as whether other dimensions might be equally relevant for international management – is still open for debate.

This paper argues that an appropriate interpretation of the most relevant dimensions of distance can serve as a benchmark for progress in international management. This entails the integration of two scientific approaches in particular: international business/management (IB/IM) and international business and society management (including international business ethics). Both disciplines have recently started to acknowledge that they have reached certain boundaries in their method and concepts, and that they could learn from each other. In IB/IM, the leading research question can be summarized as ‘what determines the international success and failure of firms’ (Peng, 2004, p. 106). But, this agenda seems to be ‘running out of steam’ (ibid., p. 105). An increasing number of scholars blame this in particular to a lack of societal ‘feeling’ of the studies. ‘Although international business scholars are arguably the prime experts on MNEs, they have contributed relatively little to explaining and evaluating “the role of MNEs in society”’ (Meyer, 2004, p. 261). Studying the relationship with society is vital for further progress in international business research (cf. Teegen, Doh, & Vachani, 2004).

In Business and Society Management (B&S) studies, on the other hand, the international research agenda has yet to come under steam. It is a relatively new field, and its academic community remains rather diverse.
The Past, Present and Future of Managing Distance

One area in which both research agendas can come together is in the ‘management of distance’. This paper explores the past, present and future dimensions of the management of distance (with)in multinational enterprises. It materializes at the interface of international business and societies. Four dimensions in particular influence the internationalisation and ICR strategies of firms at this interface: (1) past strategic choices for specific internationalization and corporate responsibilities, which in turn are influenced by (2) home country, by (3) host country institutions and by (4) international institutions (Fig. 1).

The exact relationship between these four variables and their consequences in particular for trade and foreign direct investment (FDI) at the macro-level and for international management at the micro-level of analysis, has been studied along a variety of dimensions and topics (country-of-origin effects, entry, mergers and acquisitions, bargaining relations, learning). This contribution explores the extent to which the nature of these relationships can be determined by the (absolute or relative) distance between home and host countries. The ‘business case’ for internationalization strategies – i.e., what makes an internationalization strategy successful – critically depends on the effective management of the various dimensions of distance that exist in particular between home and host countries. The idea has gone through three phases of theory building and empirical testing: in the past the focus was on generally applicable and relatively mechanistic models regarding geographic, psychic and cultural distance (see ‘The Past: Ambiguous Results for Geographic, Psychic and Cultural Distance’). At the moment the attention has started to move towards the ‘rules of the game’, i.e., the institutional and governance distance between countries (see ‘The Present: Institutional and Governance Distance’). Both traditions leave important gaps in our understanding of distance: first on the exact nature and weight of the relationships, secondly on the actors involved. Future progress will have to be achieved by moving from ‘factors’ (institutions, culture) to
‘actors’ (stakeholders) and by moving from general managerial relevance to (also) include societal relevance. This paper proposes therefore to include two complementary distance dimensions: stakeholder distance and development/normative (see ‘The Future: Normative and Stakeholder Distance’). All these dimensions combined define the future strategic as well as ethical ‘room of manoeuvre’ for MNEs and their managers.

THE PAST: AMBIGUOUS RESULTS FOR GEOGRAPHIC, PSYCHIC AND CULTURAL DISTANCE

In the 1960–1980 period IB scholars examined business–society interaction primarily at the interface with host governments, institutions and cultures. Since many cultures and institutions are relatively static, most dynamic (bargaining) interaction took place between companies and host governments. International management focused on conducting risk assessments
and smart cross-cultural management practices. Political or country risk analyses (PRA) entailed primarily host country characteristics, with the objective of achieving economic success ‘despite’ risky political environments. Risk analyses focus on the ‘liabilities of foreignness’. They presuppose a relatively adversarial position of the multinational firm vis-à-vis host stakeholders such as local governments, citizens, firms and suppliers (Wells, 1998). ‘PRA encourages firms to overlook ethical concerns and issues of social responsibility in favour of single-minded self-interest’ (Getz, 2004, p. 22). The dimension of distance in this context (i.e., as risk enhancing factor) was first conceived of as ‘geographical distance’.

The idea of geographical distance builds on the classic gravity models of international trade theory, which show that trade flows between countries is highly proportional to the product of their absolute gross domestic products (GDP). In gravity models, the size of the economy functions as the predictor for trade flows. Most gravity models also show a strong negative effect of distance on international trade (Krugman & Obstfeld, 2006). In empirical IB studies, geographical distance normally functions as ‘control variable’, for instance, in accounting for trade and investment flows and the consequences of international activity for firm profitability (e.g., Lu & Beamish, 2004; Ruigrok & Wagner, 2003). Geographic distance refers to the physical remoteness of countries. This distance dimension has been used to explain the amount of merchandise trade between countries, as well as the magnitude of countries’ FDI inflows and inward FDI stocks. It has been found that the amount of merchandise trade between countries decreases with the geographic distance between them increasing. The costs of transporting merchandise increases with geographic distance. Geographically distant countries have also been found to have lower FDI inflows and lower inward FDI stocks (Braconier, Norbäck, & Urban, 2005), presumably because senior MNE managers generally find it more difficult and costly to monitor subsidiaries located in geographically distant countries, thus lowering their incentive to establish subsidiaries in such countries (Shenkar, 2001).

The idea of a psychic distance was first introduced by Beckerman (1956) and related to the explanation of trade flows and (thus) the question where to start foreign operations. It became most popular as part of the Uppsala internationalization model (Johanson & Wiedersheim-Paul, 1975; Johanson & Vahlne, 1977). Psychic distance was thereby related to factors which impact the information flow between the firm and the host market, such as language, culture, political system, level of education and level of industrial development. However, the concept has been rather vague and
difficult to operationalize (Ojala & Tyrvainen, 2009), despite a large number of recent efforts to do so at the macro-level (Brewer, 2007; Dow & Karunaratna, 2006; Evans & Mavondo, 2002), or at the individual level, such as education, international experience and age (Dow & Karunaratna, 2006). An obvious recent effort has been to capture the managers’ perceived psychic distance (or perception of reality) between the home and the host country (Sousa & Bradley, 2005). The introduction of such subjective measures implies that psychic distance can vary per person, which, however, makes it very difficult to address at the organizational (MNE) level.

Research on cultural distance complements the research on geographical distance and partly overlaps that of psychic distance, by focusing in particular on entry modes in host countries (Kogut & Singh, 1988; Brouthers & Brouthers, 2001). Cultural distance can be defined as the extent to which the shared norms and values in a specific host country differ from those in the MNE’s parent country (Hofstede, 1980). Culturally distant countries have divergent organizational and management practices, consumer preferences (Ghemawat, 2001) and communication styles, making it difficult for MNEs to successfully do business in such countries. The cultural distance to a country has been shown to have a negative impact on the amount of FDI in that country (Sethi, Guisinger, Phelan, & Berg, 2003), as well as on the performance of foreign subsidiaries in general and international joint ventures (Mjoen & Tallman, 1997), and cross-border acquisitions (Datta & Puia, 1995) in particular. Furthermore, entry mode research tends to suggest that a large cultural distance leads MNEs to prefer joint ventures over wholly owned subsidiaries and greenfield over acquisition entry (Larimo, 2003). Cultural distance can play the role of moderator in international acquisitions, although its effect can be both negative and positive (Reus & Lamont, 2009).

The exact effect of cultural distance on international management remains rather ambiguous, certainly when other dimensions are taken into account. Governance quality/distance seems a better predictor than cultural distance for the choice between a wholly owned subsidiary or a joint venture as entry mode (Slangen & Van Tulder, 2009). An increasing number of scholars, therefore, talk about the ‘cultural distance paradox’ to cover for the lack of clear and consistent evidence in almost every area of its application. The obligatory reference to cultural distance seems to have outlived its usefulness (Drogendijk & Zander, this volume). But this might not be because of its general uselessness, but because of its particular usage as ‘mechanistic’ and ‘one-size-fits-all’ formula in the international business discipline. Drogendijk and Zander (this volume) talk about a number of
telling ‘illusions’ that affect the idea of cultural distance: simplicity, appropriateness, symmetry, stability, linearity, causality, discordance, neutrality. Rather they content that cultural distance is not absolute, but relative and can also be treated as a source of opportunities, rather than only a source of ‘trouble’. Cultural diversity as a result of larger cultural distance has also been shown to be of strategic advantage to a company: greater creativity and innovation; targeting of a greater variety of customers; greater adaptability to environmental changes; more diverse teams of employees are more likely to disagree with each other and thus find fault with the status quo. Taking the positive effects of a multi-dimensional, multi-level concept of distance into account – rather than to delimit its function as the source of ‘troubles’ – can enrich the study of international management (ibid. and ‘The Present: Institutional and Governance Distance’ of this paper). Comparable types of argumentation can be used for the treatment of geographic and psychic distance.

AGENDA FOR THE FUTURE

Referring to Fig. 1, the above findings necessitate two types of fine-tuning. First, on the nature of the arrows – they should also account for asymmetric relationships, in which the distance variable is a weighted average of home country and host country effects. In general, it can be assumed that home or ‘country of origin effects’ still prevail over host country effects in this equation. The arrow from home country to MNE strategy, in general therefore, should be thicker. This is true for the generic internationalization strategies of multinationals as well as of more specific ICR strategies, such as codes of conduct, reporting, environmental strategies (cf. Van Tulder & Van der Zwart, 2006). Secondly, the ‘space’ or ‘room of manoeuvre’ taken by the multinational enterprise (the dotted box around the MNE) is flexible. The bigger the absolute distance, the bigger the room of manoeuvre for the company, but the higher also is the initial coordination costs. The smaller the relative distance, the lower coordination cost, but the small also is the room of manoeuvre at both a strategic and ethical level. In terms of ‘culture’: the greater the distance, the greater the impact of the ‘corporate culture’ over national/local cultures can be or need to be. As a consequence, the bigger the company’s internal strategic decision making space (or corporate culture) the greater is its independent impact on international trade and investment flows.
THE PRESENT: INSTITUTIONAL AND GOVERNANCE DISTANCE

Since the mid-1990s, institutions have increasingly been acknowledged as a key determinant for success and failure of economic behaviour. Scott (1997) distinguished three types of institutions: regulative, normative and cognitive. This elaboration is often used by international business scholars. Kostova and Zaheer (1999) were thereby the first to introduce the term ‘institutional distance’. The concept of institutional distance can be defined as the extent to which countries differ from one another in terms of these three types of institutions (Kostova & Zaheer, 1999). Since normative and cognitive institutions are conceptually close to culture, regulatory institutions can be considered the distinguishing aspect of the concept of institutions. Besides, it can be argued that Scott’s distinction between ‘normative’ and ‘cognitive’ institutions is difficult to operationalize. Therefore, in many discussions, the more general characterisation, as introduced by Douglas North, of institutions as (formal and informal) ‘rules of the game’ has been used.

On the basis of theoretical reasoning, Kostova and Zaheer (1999) expected that the greater the institutional distance is between the home country of an MNE and a particular host country, the greater the challenges an MNE subsidiary will face in establishing and maintaining its legitimacy in that host country. Cultural and institutional distances are largely considered complementary. Xu and Shenkar (2002) sketch the role of institutions as articulating, disseminating and arbitrating cultural and social cues. Institutional distance provides a partial contingency factor for effects of ownership and host country experience in institutionally distant countries, subsidiaries have better survival chances if foreign parents have more ownership (Gaur & Lu, 2007). Others have stressed how formal and informal institutional distance – for instance, in the relationship with emerging markets (Estrin, Ionascu, & Meyer, 2007) – affect business strategies in opposite ways.

But few attempts have been made to operationalize the concepts of institutional quality and institutional distance. Efforts to empirically operationalize institutions as ‘rules of the game’ come with a number of synonyms, such as ‘governance’, ‘administrative’ or ‘regulatory’ distance, all of which can be defined as the extent to which the administrative system in one country – consisting of rules, laws, regulations and government policies – differs from that in another (Ghemawat, 2001; Xu & Shenkar, 2002). Firms entering countries with a radically different administrative
system experience high levels of uncertainty and will hence find it difficult to successfully do business there. Consequently, Xu and Shenkar (2002) proposed that MNEs are more likely to enter such countries through minority-owned joint ventures rather than through wholly or majority-owned ventures. Xu, Pan, and Beamish (2004) found that a large regulatory distance indeed leads MNEs to choose lower ownership stakes in their foreign subsidiaries. Habib and Zurawicki (2002) found that greater absolute differences in corruption levels between countries result in smaller FDI flows between them. Instead of focusing on the administrative distance between parent and host countries, some studies focused on (aspects of) the administrative quality of the host country. Delios and Henisz (2000) found that MNEs take lower levels of equity ownership in subsidiaries located in politically unstable countries, while Globerman and Shapiro (2003) found that countries with a high-quality administrative system receive more US FDI. Habib and Zurawicki (2002) found that corrupt countries receive significantly less FDI than non-corrupt ones.

There are basically two problems with these studies. First, most measures of institutional/governance distance are based on the perceptions of managers or other experts – either contained in global competitiveness or ‘governance quality’ measures. Empirically these measures face comparable problems as those associated to ‘psychic distance’. Secondly, and related to this problem, there is often an implicit bias for absolute governance/institutional measures rather than relative (institutional distance) measures. This first problem calls for different sets of indicators. The second problem calls for relative measures of distance. Both have to be addressed at the same time.

Influential benchmark indicators for measuring ‘governance quality’ (and governance/institutional distance as its derivative) are provided by the World Bank group (Kaufmann, Kraay, & Mastruzzi, 2004). Many studies (Globerman & Shapiro, 2003) have used these ‘meta-indices’ of governance quality to explain FDI and trade flows between countries. Globerman and Shapiro (2003), for instance, found that liberal countries whose legal systems are rooted in English common law – with less market regulation, less codification and more case law, providing better protection of shareholders, creditors and property rights – are more likely to receive FDI. This finding hints at the fundamental importance of specific regimes, as opposed to the importance of their distance. On closer scrutiny, the findings of Globerman and Shapiro contain a significant empirical bias. The empirical proof only came from the foreign investments made by US firms. Furthermore, the research accredited the liberal regime with the highest
degree of governance infrastructure ‘quality’. Selection bias is a common empirical problem in international business studies. What Globerman and Shapiro found, therefore, was not an absolute measure of the sophistication of any institutional model, but a context-bound impression of the importance of institutional and governance distance: US companies tend to invest more in countries with a comparable legal orientation and governance regime. So, the shorter the regulatory and institutional distance between countries is, the greater the likelihood of mutual FDI flows.

Support for the effect of institutional distance on flows of FDI has also been found in the relationship between former colonies and the United Kingdom, also known as the ‘commonwealth’ effect (Jones & Lundan, 2001). Jones, Lundan, and Burke (1997) argued that an average advantage of 10–15% accrues from being attached to the former colonial network. This pattern reveals the considerable ‘sunk cost’ effects related to FDI flows, and also the effect of low transaction costs that accompany investment in a country that shares the same legal and governance regime. French multinationals have found it easier to sustain their internationalization strategies to countries where the institutions resemble the ‘home’ base (in particular in North and West Equatorial Africa) and where they were not expropriated after decolonization (as happened in Vietnam and Cambodia). In many of the former African French colonies, therefore, French multinationals are still amongst the leading companies. In the same vein, cross-border investment in continental Europe has been facilitated by a legal system based on Roman civil law despite the fact that this implies more regulation of markets and more bureaucracy as a result of higher degrees of codification. The same seems to apply to countries that share a legal system based on customary or religious law and comparable regimes. Institutional proximity often seems more important than geographical proximity.

Studies that focused on corruption revealed comparable patterns. Habib and Zurawicki (2002), for instance, found that corruption on the one hand creates a serious obstacle to FDI; but they also found a negative effect due to the difference in corruption levels between the home and host countries. This implies that firms experience considerable operational pitfalls when confronted with a different – not necessarily higher or lower – corruption level than in their home base. Recent studies on the nature of investment by Chinese corporations in Africa reveal comparable explanatory frameworks: the relative small distance between the Chinese and African regimes (often authoritarian) strongly facilitates investment. Explanatory frameworks for emerging market multinationals have always searched for reasons why these firms internationalized predominantly to other developing countries
AGENDA FOR THE FUTURE: REGIME DISTANCE

Referring to Fig. 1, the literature on the impact of either home or host country regimes on FDI and trade suggests an absolute relationship which is often caused by an interest in establishing a unilateral relationship between FDI and home country or host country institutions. Alternatively, it proofs better to stress the importance of relative measures, for which institutional distance seems an obvious measure. However, the elaboration of institutional distance remains surrounded by serious methodological and conceptual drawbacks. One way to move from a neutral analysis of amorphous institutions to a more substantive analysis is by linking the distance concept to the ‘business systems’ (Whitley, 1999) or ‘varieties of capitalism’ discussion. Institutional distance then becomes ‘regime distance’.

In the IB application of that literature ‘institutional differences’ are used as an explanation for export performance. One of the most important roles of MNEs is to use arbitrage to profit from institutional complementarities. Four main types of regimes can be distinguished. First two classical types of capitalism: liberal market economies (United States and other Anglo-Saxon countries) and coordinated market economies (Germany and other continental European countries in particular). In discussion on ‘business systems’ also East Asian economies (China and South Korea, but also Japan; see Van Tulder & Van der Zwart, 2006) as well as Middle Eastern countries (with their typical impact of religion on the operation of business) should be identified as home and host to MNEs. The relative distance between these regimes can be hypothesized as in Table 1.

Multinationals originating in liberal and coordinated market regimes have the least difficulty entering host countries with the same regime. Both regimes show considerable overlap, and are also relatively open to host MNEs...
independent on their country of origin. Firms originating in liberal countries will find it easiest to enter other liberal countries. But they will find it much more difficult to cope with the greater emphasis on consultation with employees and other stakeholders in the coordinated market economies of continental Europe. European MNEs will find it easier to enter other CMEs than liberal countries. The distance vis-à-vis liberal regimes is particularly large as regards degree of transparency required and personal liability. In the American regulatory regime firms run the risk of being taken to court for their international activities which could result in significant reputational damage on stock markets. From the European MNEs’ perspective, the ‘quality’ of the American governance regime is not necessarily superior as could be suggested from World Bank research, which confronts them with the question of whether they should adopt semi-optimal strategies. The same applies to American multinationals investing in Europe.

The two other regimes exhibit considerably higher barriers to entry. Entry to these countries is difficult even for a multinational originating from a country with the same regime. Consequently, even Arab MNEs will have to adopt focused strategies if they plan to enter other Arab countries. Part of the Asian and the American regime overlap, first because of a shared emphasis on efficiency (cf. Van Tulder & Van der Zwart, 2006); secondly, leading Asian economies (China, Japan and South Korea) have linked their (export-oriented) currency and fiscal models directly to that of the United States, creating additional dependencies between the two regimes – for instance, in covering for the double deficit of the United States. Companies from other regimes entering the East-Asian region face a considerable number of institutional difficulties. The Western firm entering the guanxi business network in China and other networked business systems in East Asia is confronted with more informal arrangements and much lower control on corruption. Besides, the (informal) requirement to team up

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with local companies provides an increasing barrier to profit from market entry in China.

With greater institutional distance comes greater external uncertainty, which also affects the classic entry choice. At the level of individual firms, institutional distance towards a host country reflects a better predictor of an MNE’s choice of foreign entry mode than cultural distance (Slangen & Van Tulder, 2009). Matching internal and external uncertainty provides important routes for further research and could add to the prevailing ‘outside-in’ perspective vis-à-vis institutional distance. MNEs create their own institutions across borders, for instance, in the form of codes of conduct, labels and either ‘rules of the game’ which in many instances supersede national regulation. The outside-in perspective of international business, therefore, should be complemented with an ‘inside-out’ perspective. Two further challenges are related to the institutional agenda. One is to include international institutions. Increasingly regional integration agreements influence the internationalization trajectories of firms (Rugman & Collinson, 2009). New formal and informal international regimes – ISO, UN, OECD – have an impact on the operations of multinationals. Many of these international regimes develop on the basis of partnerships with MNEs. The extent to which these international regimes mediate the distance variable is still open for debate, but critically depends on their effect on creating convergent/isomorphic or divergent institutional settings in particular at the national level.

THE FUTURE: NORMATIVE AND STAKEHOLDER DISTANCE – OUTLINE OF A RESEARCH AGENDA

A future research agenda for research on distance preferably takes the strengths of the earlier discussions (insights on the importance of relative distance in institutional as well as economic terms), corrects for their weaknesses (factors instead of actors, institutions instead of stakeholders, undimensional indices) and adds in particular the perspective of international corporate responsibilities (cf. ‘Introduction: Distance and Advances in International Management’). This should help in better assessing the room of manoeuvre for managers of multinational corporations both strategically as well as ethically across borders. Two approaches are particularly helpful in this area: business ethics and stakeholder theory. This section explores their insights for IB in general and for the management of relative distance in specific.
An ethics perspective on IB modestly developed already in the late 1980s. It was acknowledged that for multinational companies, the tension between different systems of ethics/norms is the rule rather than the exception. Business ethicists were the first to address specific ethical dilemmas associated with international business operations. Watson and Weaver, for instance, noted that the level of internationalisation is strongly related to the level of concern company executives’ display towards ethical issues. Executives of international companies are more aware of ethical dilemmas that primarily materialize in case they either open subsidiaries in developing countries (offshoring) or extent their outsourcing networks to weakly developed constituencies. The related dimension of distance with these ethical issues can therefore be described as ‘normative’ or ‘development’ distance.

In the classic gravity models (see ‘The Past: Ambiguous Results for Geographic, Psychic and Cultural Distance’) multinational enterprises are treated as anomalies that could explain – next to, for instance, cultural factors – for less than optimal flows of international trade (Krugman & Obstfeld, 2006). Gravity models thereby mix up absolute (size of GDP) and relative distance measures. So Ghemawat follows a classical macro-economic reasoning when he states, ‘[t]he wealth or income of consumers is the most important economic attribute that creates distance between countries, and it has a marked effect on the levels of trade and the type of partners a country trades with’ (2001, p. 145). He argues that both developed and less-developed countries tend to trade more with developed countries than with less-developed countries. In IB literature, ‘economic distance’ is sometimes used. It refers to the extent to which countries differ from one another in terms of their level of economic development. This type of distance can therefore also be referred to as ‘development distance’ (Van Tulder & Van der Zwart, 2006). In case relative distance matters more than either gravity or absolute distance, countries with similar levels of economic development have similar demand structures, and hence trade more with one another than those with different levels of economic development. This is the statement already made by Linder in 1961, who suggests that less-developed countries as a consequence will trade more with other less-developed countries. If MNEs are not treated as anomalies of international trade, but rather as predictors of trade through their investment patterns, the recent stream of research of ‘emerging market multinationals’ has already indicated that one of the most telling
characteristics of these multinationals is, that they primarily invest in other developing countries (cf. UNCTAD, JIBS, ICC). In other words, for investment patterns relative economic/development distance counts more than absolute distance.

The interesting addition of international business ethics to the traditional treatment of distance is that this discipline adds an inside-out and a ‘space’ perspective to the discussion. Donaldson and Dunfee identified this as the *moral free space*. In this space, unequivocal rules of conduct and legal prescriptions are absent and ethically accountable conduct is not necessarily synonymous with socially accountable conduct. In the moral free space, all persons, stakeholders and companies are entitled to formulating their own individual point of view. The acceptability of the perspectives will, however, be determined by societal stakeholders and public opinion. Donaldson and Dunfee developed an integrated social contract approach (ISCT) that is aimed as a compass in the maze of normative approaches that exist in the moral free space: relativism – or moral pluralism and hypernorms – or universalism. Donaldson (1989) examined the dilemmas created by differences between home and host country norms and values. He argued that while international firms should respect fundamental human rights, they are not responsible for honouring human rights in precisely the same manner as nation states or individuals (*ibid.*, p. 145). The focus of Donaldson’s research was the problem of conflicting home and host country norms and the viewpoint that it is often not acceptable to abide by the principle that ‘if our practice does not break one of their laws, it’s OK’ (*ibid.*, p. 146). Donaldson adapted the quest for universal principles for international business practice to accommodate relative levels of economic development. This led him to conclude that international companies do not always have to apply the highest standards possible, for instance, when dealing with repressive regimes. Advocates of a universally applicable set of standards and rights and risks are often branded as ethical imperialist. The conviction that one must always uphold the norms of the home country even if, as is the case for many multinational enterprises, they differ from those of the host country is on a par with ethical imperialism. The perspective holds that international firms should respect the fundamental principles that function as minimum requirements for socially, ecologically and ethically responsible corporate conduct: so called ‘hypernorms’. International HRM scholars have stressed that adopting universal moral standards also improves the competitive position of multinationals.

The principles of moral pluralism and hypernorms combined, constitute Donaldson and Dunfee’s integrative approach to solve some of the ethical
dilemmas of international business: a minimum set of universal human rights combined with a moral free space that allows local ‘contracting’ provided global norms are not violated. The ‘integrative’ approach requires strongly coordinated strategies and norms and is particularly appropriate for MNEs that are somewhere in between the global and multi-domestic strategies. Secondly, MNEs have to take the level of development of the host economy relative to the home economy into account. The relative economic development of home and host countries has the biggest impact on what can be considered normatively appropriate strategies for MNEs. MNEs investing in the least-developed countries face challenges that cannot be solved by either adapting to local customs, or imposing the own norms on the economy. Reed (2002) speaks thereby of ‘development ethics’ in searching for an integrative approach to international stakeholder management vis-à-vis developing countries. Issues that are related to levels of development include in particular child labour and working conditions, not necessarily corruption, collusion or bribery. It has been already recognized that effectively addressing these development issues, requires a separate – more integrative – approach that, for instance, uses broader and positive duty-oriented codes of conduct (cf. Kolk & Van Tulder, 2005).

Managing normative distance by modern MNEs thus in practice increasingly boils down to managing ‘development distance’: the bigger the development distance between the home and the host country of a firm is, the bigger the ‘moral free space’ becomes, the bigger the ethical dilemmas are and the bigger the need for an integrative approach to corporate responsibilities. Development distance can be operationalized as differences in factor endowments related to differences in GDP. It has been found in international business research that firms tend to engage in horizontal affiliates (market-seeking and multi-domestic strategies) in case of big differences in relative factor endowments (a small developmental distance), and in vertical affiliates (implying an internal international division of labour) in case of relatively big differences in relative factor endowments. The preference for vertical affiliates is easy to understand: MNEs affiliates in the least developed countries have less possibility to ally with local companies, face bigger uncertainties and thus require a bigger control of headquarters. So, in case of ethical dilemmas connected to a large development distance, the likelihood increases that firms can consider this as a ‘company internal’ challenge. This enables a particular kind of corporate leadership. It has been suggested that in case of big development distance the most effective approach towards typical ethical dilemmas such as child labour seems to imply that managers show ‘transformational leadership’
in which they are not afraid to adopt strategies and codes of conduct that deviate from the ‘common denominator’ in the sector (cf. Kolk & Van Tulder, 2004).

Institutional and Stakeholder Distance

International stakeholder management adds considerable complexity to local stakeholder management by adding more actors with diverging – and often conflicting – interests across geographical, cultural and normative borders. Shell, for instance, estimated that in local projects it engages approximately 10–25 stakeholders who often share a common interest. In the case of strategic international issues, Shell claims that there are over 100 different stakeholder groups with highly diverse interests. In international stakeholder management, managers have to consider a number of additional dimensions vis-à-vis ‘national’ stakeholder management: between home and host stakeholders; secondary stakeholders can take on the status of primary stakeholders and vice versa; the concept ‘corporate citizen’ often acquires a different meaning in an international setting; the impact of international stakeholder groups has to be assessed more systematically.

Wartick and Wood made a first effort in mapping international stakeholder relationships. They mapped intercultural differences in stakeholder environments, by introducing a hypothetical example in which they distinguished between home and host countries. In their hypothetical example the list of home country stakeholders is considerably longer than for the host country stakeholders. One reason is that ownership is often located in the home country of the firm. The owners can largely be considered the most influential stakeholder. In the home country, the company also has its original customers who often exert considerable influence even when the importance of the domestic market has become eroded. Getz (2004, p. 25) suggested, however, that the stakeholders that are most likely affected by international business transactions are those within the host country. This is true in particular at the time of the entry. The list of primary stakeholders (as those actors without whom the company cannot realize its objectives) at the time of entry of a firm is generally more elaborate. Local governments, local communities and local competitors are particularly affected immediately before and after the entry of a foreign firm. In general, stakeholder management literature, they are usually referred to as ‘secondary stakeholders’. But their attitude at entry directly influences the success of the new entrant. The changing role of host
governments as prime stakeholders in interaction with investing MNEs is an integral part of the classic obsolescing bargain of Vernon (1971). The role of the media at entry is often also more active and decisive for the success of a new entry. The more negative effects for the local economy prevail, the bigger the sense of urgency becomes.

At the time of the entry decision, complex trade-offs appear also in the relationship of the multinational enterprise with its home constituency, in particular its employees, trade unions and local governments. Escape motives are integral part of this trade-off. What could be the net effect on the home economy? The internationalisation process always feeds the fear of traditional primary stakeholders that they could slip down the hierarchy and become secondary stakeholders. This is in particular the case in the relationship with employees (and trade unions). For instance, the direct ‘relocation’ of a factory to a low wage country involves closing down the site in the home base and opening it in the host country. Trade unions representing employees in both countries have contradictory interests. National governments can fear that they lose their primary stakeholder position and their ability to accumulate taxes because of the greater possibilities of transfer price manipulation of international companies. By moving the headquarters of a firm out of the home country, a company gives perhaps the clearest sign of a dissident position vis-à-vis the tax regime of its home government. Host governments that primarily attract firms because of their ability to accommodate tax evasion, however, remain relatively weak bargaining partners towards the MNE, not in the last place because there is fierce competition between an ever-larger number of locations. At the same time, tax havens are increasingly running the risk of getting blacklisted by other governments.

International stakeholder management in practice already becomes part of a ‘social risk assessment’ operation. By anticipating the positive or negative effects of the internationalisation decision on the home and host stakeholders, managers can predict whether they can be seriously affected. This assessment therefore also requires that firms assess the effects on their home stakeholders at the time of an exit strategy. Four primary stakeholder groups in particular affect the trade-off between home and host stakeholders: owners, employees, suppliers and governments.

- **Owners/shareholders**: part of the alleged globalization process materialized in firms spreading their stock portfolio over different host stock markets, in particular in Asia (Hong Kong, Tokyo), Europe (London, Euronext) and the United States (NYSE and NASDAQ). National stock markets at the same time, however, remain still dominated by big national players.
They constitute the largest local funds and dominate the various ‘indices’ that affect the general stock climate in a country. Being a ‘host’ company in a foreign stock exchange thus also entails dependency on the financial well-being of local competitors via stock sentiments. Differences in the degree of transparency required for going ‘public’ in a host country has already withheld firms from more closed systems to opt for a foreign stock listings. Swiss multinationals have traditionally abstained from a public listing in the United States because of the higher degree of transparency required by the SEC than in their home country. After enactment of the Sarbanes–Oxley law in the United States, which seriously changed the accountability rules of companies listed on American stock exchanges, big companies from Europe and Japan seriously started to contemplate their withdrawal from these bourses, which in turn has had a moderating effect on the operationalization of the law.

- **Employees**: the exact impact of internationalisation on the trade-off between home and host employment has been an unresolved issue. Still the bulk of employment in most companies is located in the home market, making the home employees and their trade unions still strong primary stakeholders. For the group of the most international MNEs, only after 1997 did their foreign employment outnumber their domestic employment. The effect strongly depends on the shape, location and motivation of the internationalisation strategy. Direct employment effects of internationalisation within multi-domestic firms, for instance, are in favour of the host workers, thereby substituting for home employment. Established multinationals on the other hand show a more complex picture: host employment remains stable, home employment declines. The latest generation of multinationals that only started internationalisation in the 1990s – so called ‘new generation multinationals’ (Van den Berghe, 2003) – show positive employment effects in both home and host economies, although with a slight preference for host employment. For firms aiming at a regional division of labour, the effects are more mixed.

- **Suppliers**: an assessment of the net employment effects of internationalisation should also include the indirect employment effects on suppliers and local communities. Foreign firms in host community not only creates direct and indirect positive effects, they can destroy local employment by ‘crowding out’ local firms. In general, foreign firms are supposed to contribute positively to employment, but there is still considerable debate as to the ‘quality’ of this employment. Indirect employment effects tend to be underestimated when assessing the effects of a relocating firm, and overestimated when legitimising support.
Governments: international stakeholder management involves in particular a more interactive approach towards governments. The political risk assessment then becomes supplemented by a portfolio of business–government relations. Firms operating on government procurement markets always had to adopt a multi-domestic strategy to become recognized as an ‘insider’ in the various countries. Balancing the trade-off between the public interest in home and host countries requires an intricate game in which the rewards are difficult to assess. For instance, Motorola – as one of the first entries in China – has attempted to become part of the Plan, including the acceptance of the intentions of Chinese planning authorities as indicators of demand, rather than making its own independent analysis of market conditions and trends. One Motorola executive put it like this: ‘you have to fit into their agenda, become one of their stakeholders’. Consequently, Motorola has been actively lobbying for a most-favoured-nation status of China as well as its admission to the WTO (ibid., p. 330). The risk for Motorola is that it might also have created the preconditions for Chinese firms to enter its home turf, which in the end might affect its competitiveness. The continued practice of forcing American firms to enter into alliances with domestic Chinese companies in order to gain market access in 2010 led to increased irritation with American companies. They expressed their discontent in a typical manner: they showed increasing reluctance to act as an ally for China in the internal US debate on dealing with the undervalued renminbi.

Secondary stakeholders: management also entails the relationships with secondary stakeholders. One recent study has even studied this relationship in terms of ‘civil society distance’ (Kourula, in press). The engagement strategies of MNEs with NGOs in environment, human rights and the like can be considered to be equally relevant. Kourula identified three types of relationships (sponsorship, dialogue and partnerships) across borders which affect the corporate societal legitimacy, its risk management and learning strategies, for instance, through reputational benefits. This study was based on one case study, but the concept of civil society distance is a good first elaboration of the secondary stakeholder relations of MNEs.

*International Strategic Management: Managing Stakeholder Distance*

Prescriptive stakeholder theory on the moral obligations of managers towards their international stakeholders has made considerable progress.
Descriptive stakeholder management theory on the actual behaviour of managers, firms and stakeholders, however, trails considerably behind. At present, the approach to international stakeholder management is largely procedural. Strategic choices for particular internationalisation strategies are rarely specified. When internationalisation strategies are taken into account, often a relative simple trichotomy is presented between ‘global’, ‘local’ and ‘transnational’, elsewhere also identified as ‘glocal’. The latter category then relates to the ‘integrative’ solution to ethics and builds on the ‘global-responsiveness’ grid developed by Prahalad and Doz (1987). But the strategic repertoire of MNEs is much broader and shows considerable discrepancy between strategic intentions and the strategic reality. When theorists develop ‘global stakeholder’ (or global corporate citizenship) models, they largely base their approach on the strategic intention of (mostly) American companies. But since the beginning of the 1990s, Japanese and European MNEs – as well as latecomer American MNEs and newcomer Chinese and Indian MNEs – primarily implemented export-oriented, glocal/transnational or regional strategies (cf. Rugman & Collinson, 2009).

Different internationalisation strategies impact differently on home and host stakeholders. A sophisticated international stakeholder management model takes these strategic realities into account – something that has not yet been developed. Table 2 gives a first assessment of the expected intensity of these effects and thus of the importance of what can be called ‘stakeholder distance’. The stakeholder distance is biggest when the relative impact of home and host stakeholders differs most. The bigger the distance, the more impact the reputation mechanism towards a particular stakeholder group has, the more its legitimacy can be affected. The reputation mechanism works primarily through three ‘markets’ (Van Tulder & Van der Zwart, 2006): capital (owners), consumer (customers) and labour (employee) markets, the three first groups of stakeholders in Table 2. The bigger the relative weight of these markets in the overall strategy of a particular company is, the stronger the effects of the reputation mechanism becomes.

A sophisticated international stakeholder analysis starts with measuring the relative transnationality index (TNI). Then take the specific organisational characteristics of the company into account and the strategic idiosyncrasies of this particular kind of organisation. Combined with a more detailed assessment of the nature and motives for internationalisation, the relative impact of specific groups of stakeholders can be assessed more or less along the lines of Table 2.
Table 2. Assessing Stakeholder Distance: Hypotheses on the Relative Impact of Primary Stakeholders.

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<th>Export Oriented</th>
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<th>Regional</th>
<th>Glocal/Transnational</th>
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<td>Home</td>
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<tr>
<td>Owners/shareholders</td>
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<td>Strong</td>
<td>Weak</td>
<td>Medium</td>
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<tr>
<td>Customers</td>
<td>Weak</td>
<td>Strong</td>
<td>Medium</td>
<td>Medium</td>
<td>Weak</td>
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<tr>
<td>Employees</td>
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<td>Suppliers</td>
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<td>Governments</td>
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Globalization: one of the chief strategic objectives of ‘global’ firms is to be as independent of specific markets, countries and customers as possible. One of the mechanisms through which global companies work is by developing a ‘global brand’ that facilitate economies of scale in production and marketing. It can be anticipated that the relative position of national stakeholders is relatively weak, unless a number of ‘global stakeholders’ develop that can parallel the company’s strategy. Wartick and Wood define global stakeholders as a group or organisation that has cross-national membership and cross-national interests in business activities. Examples include global environmental stakeholders (Greenpeace, WWF), global political stakeholders (from the International Communist Party to NATO), global terrorist groups and global religious stakeholders. According to Wartick and Wood, the latter group of stakeholders is ‘perhaps the constituency most likely to be overlooked by US managers and scholars’. In case global stakeholders are able to discredit the global brand across borders, the whole company risks considerable reputational damage. In case the company has adopted a ‘global corporate branding’ strategy (rather than a ‘unit branding’ strategy) the negative effects can be even bigger. Global corporations, therefore, have an interest in keeping their stakeholders relatively dispersed. In the practical implementation of ‘globalisation strategies’, the discrepancy between intended and realized strategies often remains quite large. So, capital and ownership ties, as well as political ties with the home country prevail even with ‘global corporations’. Even the greater market part of many so-called ‘global’ firms’ activities is still located in the home or regional market. The reputation mechanism for real global firms, probably works strongest through the capital market in the home base and the consumer markets in their largest host bases.

Export-oriented enterprises: these are almost by definition firmly rooted in their home economy and draw their international competitive strength from their local environment or clusters – placing local stakeholders at a strong position. If the export orientation is extremely successful, the position of domestic customers as primary stakeholders, however, can mitigate. If the majority of a firm’s customers get located in another market (for instance, in case of a firm exporting from a small country to a neighbouring large country), the relative importance of the host customers in its overall stakeholder management approach can surpass that of domestic stakeholders. The reputation of the company in the domestic capital market and with domestic employees has the
biggest effect. But in case one host market is very prominent, the reputation mechanism will work even stronger through this market, because the company will not be less able to influence other host stakeholders in the same manner as it would with home stakeholders. In the main host market, the local competitors are seriously affected by the export strategy of this firm, so they might also share an interest in discrediting this company and thereby get rid of another competitor. The host group of local competitors (often with good connections to their own governments and other groups of stakeholders) thus becomes an influential stakeholder.

(3) **Multi-domestic**: the impact of primary stakeholders is very dispersed for multi-domestic companies. Because multi-domestic companies aim at being recognized as ‘loyal’ local corporate citizens in all the markets they operate in, they also face the biggest coordination problems. Consequently the relative impact of host stakeholders increases. Dependent on the spread of activities and the relevance of a host market, however, a multi-domestic strategy also represent a risk-spread strategy; it is more easy of the company to get rid of specific affiliates, so the impact of host stakeholders decreases as well, rendering the reputation mechanism relatively blunt for the company as a whole.

(4) **Glocalisation/transnational**: in its approach to home and host stakeholders, resembles the export-oriented strategy, but the impact of host stakeholders in its core markets abroad increases relative to the export-oriented strategy. In case home and host country regimes conflict, glocalisation is bound to lead to greater support for international standards, as proposed by organisations that resemble most the own regime. So Asian MNEs tend to adhere more to WTO or ISO standards, than to OECD or Independent accreditation standards. South Korean, Japanese and Chinese firms are strong supporters of ISO 14000 and ISO 9000 standards. The reputation mechanism of glocal firms still works largely through the domestic capital, labour and consumer markets. But, just like with export-oriented companies, the importance of host groups of stakeholders increases with increasing relative importance of these markets in the general strategy.

(5) **Regional division of labour**: only in the face a strategy that pursues a full-scale regional division of labour can it be anticipated that the impact of host stakeholders will equal that of home stakeholders. Under these circumstances, leading firms will become active in the design of regional institutions or a regime that lowers uncertainty and reduced transaction costs. The regional institutions or regimes will probably be a pragmatic
synthesis of the interests of the biggest economies. A regional division of labour makes it easier to spread the reputation effect over a larger number of countries that are interdependent.

**CONCLUSION: DISTANCE FROM BOUNDARY CONDITION TO OPPORTUNITY**

This paper has argued that distance in international business is alive and kicking. Next to a boundary condition for risk management, it has also become an opportunity for responsible behaviour. The proclaimed ‘death of distance’ (Cairncross, 1997) proves grossly exaggerated. Geographical distance still plays an important and often decisive role in the international strategies of companies. Distance is a multi-faceted phenomenon and needs to be weighted and embedded in stakeholder configurations across borders. This paper discussed in particular the weaknesses of traditional dimensions of distance (geographic, cultural and psychic), argued that the present stage that focuses on ‘institutional distance’ is perhaps somewhat mechanistic and concluded that adding normative/development and stakeholder distance seems particularly promising venues of advances. There is no doubt, however, that most multinationals have to manage all dimensions of distance simultaneously. The strategic room of manoeuvre of firms thereby is not only defined by external influences, but also by the creation of ‘space’ due to the adopted strategies. It is difficult to make a straightforward and attractive business case for any specific strategy. The success and failure of international firms in interaction with society, depends on the competitive position and internationalisation strategy adopted by firms. MNEs can gain substantial competitive advantage in managing these dimensions in a sophisticated manner.

The quest for timely managing normative as well as stakeholder distance relates to the search for a business case for ICR in which multinationals have to manage not only risks across borders, but also a large number of responsibilities and issues. Stakeholder management across borders (with NGOs and governments) remains a relatively uncharted area of international business, which is nevertheless of increasing importance in the management praxis – witnessing, for instance, the growing interest in increasing legitimacy (the ‘license to operate’) with local and international stakeholders. International stakeholder relations become more complex not only because more and diverse stakeholders are involved, but also because contracts,
societal systems and norms and morality tend to differ more across than within borders.

REFERENCES


B. CULTURE AND DISTANCE
CULTURAL INTELLIGENCE AND ALL THAT JAZZ: A COGNITIVE REVOLUTION IN INTERNATIONAL MANAGEMENT RESEARCH?

David C. Thomas

ABSTRACT

In recent years, international management research has focused on the cognitive development of managers as increasingly important in a complex and dynamic business environment. As part of what might be called a cognitive revolution in international management research, several individual difference constructs have been introduced that promise to improve upon our ability to link culture to action beyond the study of dimensions of cultural variability and inventories of cultural competence. In this paper, I review three of these ideas: multicultural personality, global mindset, and cultural intelligence. I examine their conceptual similarities and level of development, and identify five criteria that need to be satisfied for these new ideas to have utility in international management research.
INTRODUCTION

Globalization has made the need for effective intercultural interactions a fundamental concern for managers in all types of organizational settings. This issue is no longer exclusively focused on the ability of expatriate managers to function effectively in a foreign context, but is now a pervasive concern. The search for that certain global something that makes some individuals more effective interculturally than others has a long history and has taken many paths (see Thomas & Fitzsimmons, 2008). Many studies have alluded to the idea that there are certain attributes of individuals that allow them to be effective in cross-cultural communication (Ting-Toomey, 1999), in overseas assignments (Church, 1982; Caligiuri, 2000), or more generally, in intercultural interactions (Cushner & Brislin, 1996). The literature on cross-cultural training is filled with measures of intercultural competence, most of which are based on limited theoretical foundations and have poorly established validity (see Paige, 2004, for a review).

The search for an individual difference construct that adequately explains and predicts effectiveness in intercultural interactions continues, but has now taken a turn that is consistent with a more pervasive interest in the international management literature on the influence that the cognitive abilities of managers has in the multinational organization.

In keeping with the theme of this volume, I examine the current state of this research by exploring the past and future of three recently introduced constructs: multicultural personality, global mindset, and cultural intelligence. That is, in order to provide a way forward I look back to the origins of these constructs to understand the genesis of their constituent elements, their level of analysis, the method of aggregation of dimensions, their conceptual distinctiveness, and efforts at validation. By comparing these ideas I suggest developmental opportunities for this important area of research and its relationship to a broader focus on managerial cognition in international management research.

Multicultural Personality

The inclusion of a construct-labeled personality in the discussion of a possible cognitive revolution in international management research provides a backdrop against which to examine the increasing influence of social cognitive theory. The idea of a multicultural personality can perhaps be traced to the selection of Peace Corps volunteers in the 1960s.
(e.g., Stein, 1966). Based on characteristics thought to help the sojourner cope with new social norms, values, and languages, this research was concerned with determining an *overseas type*. The literature at the time showed a general acceptance of personality descriptions of effective sojourners. A classic description was provided by Gardner (1962), who described this so-called *universal communicator* as having a well-integrated personality, a central organization of the extroverted type, a value system that included values of all, a socialization of cultural universals, and a high degree of sensitivity toward others. The search for an international type was largely abandoned for a time as a result of the inability to find consistent relationships between personality characteristics and success in intercultural interactions (Stening, 1979) and replaced with a search for appropriate skill or behavioral dimensions (Thomas, 1998). This resulted in the numerous skills or competency inventories available today. More recently, a focus on personality has reemerged in the consideration of predictors of success in overseas contexts (see Mol, Born, Willemsen, & Van der Molen, 2005, for an empirical review). However, questions about the ability of broad personality dimensions to predict effectiveness in a specific domain (Hough, 1992) lead to the development of the Multi-Cultural Personality Questionnaire (MPQ). On the one hand, and as described ahead, the MPQ is an example of the type of competency inventory spawned by decades of research into intercultural effectiveness. On the other hand it represents a new wave of concern for defining an individual difference construct, independent of culture, that describes characteristics of the way in which people process information in a specific (in this case cultural) domain.

Based on a review of the literature on overseas effectiveness, Van der Zee and Van Oudenhoven (2000) suggested that a multicultural personality consisted of cultural empathy, open-mindedness, emotional stability, orientation to action, adventurousness/curiosity, flexibility, and extraversion. The justification for inclusion of these constructs and not others is somewhat unclear and, unlike skills or abilities, does not seem to be based on their predictive validity, or their relative stability (see Thomas & Fitzsimmons, 2008, for a review), but rather on their frequency of appearance in descriptions as factors related to overseas success. The 138 items thought to represent the above dimensions were reduced statistically to 78 items (later enhanced to 91 items) representing five underlying constructs called: *emotional stability, social initiative, open mindedness, cultural empathy,* and *flexibility*. A number of studies (e.g., Leong, 2007) have confirmed this factor structure and the reliability of the instrument. The five dimensions are not presented as representing an underlying
construct and there is a fairly high correlation among some of the factors (Van der Zee & Van Oudenhoven, 2001). Results of validity tests are often summarized as “the MPQ predicted …,” while a close examination reveals that, typical of competency inventories, some dimensions of the MPQ are predictive of some outcomes related to effective intercultural interactions (e.g., adaptation, psychological well-being, life satisfaction), whereas others are not. The measure is a questionnaire on which items are either self or other rated on a five-point scale (5 = completely applicable to 1 = totally not applicable). The scale is often described, perhaps appropriately, as a measure of intercultural competency (e.g., Leong, 2007).

Global Mindset

The seeds of a cognitive revolution in international management research can be found in the literature on multinational organizations in the form of the concept of a global mindset. This field has long recognized that the cognitive capabilities of senior managers were influential with regard to organizational outcomes (e.g., Perlmutter, 1969). The concept of global mindset was implied in the literature on international strategy (e.g., Prahalad & Doz, 1987; Kogut, 1989) and was articulated by Bartlett and Ghoshal (1989, p. 195) as a “matrix in the mind of managers.” The use of the term global mindset first appears in a practitioner article by Rhinesmith (1992) in which it is contrasted with a domestic mindset on six dimensions. Following its introduction, the concept of a global mindset spawned a veritable cornucopia of conceptualizations and operationalizations derived from both the cross-cultural and strategy literatures (see Levy, Beechler, Taylor, & Boyacigiller, 2007a, for a review). These included both one-dimensional and multidimensional concepts applied to both the individual and the organizational level. In the following, I describe two contemporary approaches (one theoretical, the other empirical) to defining global mindset.

In an attempt to reconcile the many approaches to describing a global mindset, Levy et al. (2007a) present perhaps the clearest articulation to date. They suggest that a global mindset is an individual-level cognitive structure characterized by cosmopolitanism and cognitive complexity. They elaborate on this definition by suggesting that a global mindset involves (a) an openness to and awareness of multiple spheres of meaning and action, (b) complex representation and articulation of cultural and strategic dynamics, and (c) mediation and integration of ideals and actions orientated to both the global and local (Levy et al., 2007a, p. 244). In their article,
Levy et al. (2007a) come close to specifying the way in which these two dimensions interact to create a global mindset, but never quite close the logical loop. Their specification of an information processing approach is interesting. It includes a process model involving (a) attention to multiple cultural and strategic dynamics, (b) integrated interpretation of cultural and strategic dynamics, which lead to (c) individual action. However, it lacks clarity as to how cosmopolitanism and cognitive complexity form a global mindset and how this emergent construct influences this process. They do not specify an operationalization of global mindset.

Recent work under the auspices of the Thunderbird Global Mindset Project has specified a three facet model of global mindset consisting of intellectual capital (knowledge), psychological capital (attitudes and personality), and social capital (interpersonal skills) (Hough, Fandre, & Oswald, 2008). This conceptualization and a self-report measure representing it was empirically derived based on a set of 35 attributes thought by the research team to reflect the domain of global mindset. Results of factor analysis suggest a two-factor model as opposed to a three-factor model with the social capital dimension failing to emerge, and attempts to demonstrate predictive validity have had mixed results (Hough et al., 2008).

Cultural Intelligence

The last entrant into the search for a construct that explains individual variation in intercultural effectiveness is cultural intelligence. The concept was introduced by Earley (2002, p. 274) as a three faceted (cognitive, motivational, behavioral) model that captures “a person’s capability to adapt effectively to new cultural contexts...” This introduction was followed by two books (Earley & Ang, 2003; Thomas & Inkson, 2003) from which two somewhat different conceptualizations have emerged.

Earley and Ang (2003) reiterate the three faceted model presented in Earley (2002) but in later work (e.g., Ng & Earley, 2006) the meta-cognitive (higher order control of cognitive processes) aspect of cognition is given equal status resulting in a four factor model. Likewise, the original definition of cultural intelligence that focused on adapting one’s behavior to new contexts has varied somewhat in future iterations to include “... a seemingly natural ability to interpret someone’s unfamiliar and ambiguous gestures ...”(Earley & Mosakowski, 2004), “... reflects a person’s capability to act upon these radically different cues to function effectively in cross-cultural settings ...”(Earley & Peterson, 2004), and “... an individuals’
capability to function and manage effectively in culturally diverse settings ...

This definitional migration away from adaptation to an aspect of the environment seems to weaken the link to established conceptualizations of intelligence (Binet & Simon, 1916; Sternberg, 1997; Wechsler, 1944), but need not be a limitation depending on how the construct is operationalized. That is, it could still be a viable individual difference measure without being labeled a type of intelligence.

In the earliest exposition of the construct (Earley, 2002, p. 283; Earley & Ang, 2003, pp. 86–90), the constituent elements were described as multilevel and an effort was made to describe a process through which they interacted. This fell short of specifying how the various dimensions combined to produce cultural intelligence and has been not represented in subsequent work. In this work, cultural intelligence is described as an aggregate multidimensional construct in which the dimensions exist at the same level of the conceptualization of the overall construct and the dimensions make up the overall construct (Ang & Van Dyne, 2008). However, aggregate constructs by definition are formed as a mathematical function of their dimensions (Law, Wong, & Mobley, 1998) and this conceptualization of cultural intelligence does not specify the relationship between the overall construct and the four dimensions. Thus, it is very similar to competence inventories described previously in that the relationship of each element to intercultural effectiveness must be evaluated separately.

The construct, as four separate elements, is born out of the empirical work based on this conceptualization. The measure of cultural intelligence based on this model is a 20-item self-report measure derived from an initial item pool of 40 items, which themselves were produce from a literature review and interviews with eight internationally experienced executives. The four factor structure has been found in a number of studies and the internal consistency reliability of the scales is good (Ang et al., 2007; Van Dyne, Ang, & Koh, 2008). One factor or another has been related to a number of dimensions of intercultural effectiveness (e.g., adaptation, task performance, cultural judgment; see Ang et al., 2007). However, as with the MPQ, little can be said about the relationship of the construct of cultural intelligence (measured in this way) to outcome variables. What we know has to do with the relationships to one or the other of the four dimensions. Although the dimensions seem to hold up fairly well psychometrically, other issues remain. For example, the cognitive dimension relies on self-reports of cultural knowledge such as “I know the cultural values and religious beliefs of other cultures,” and the metacognitive dimension similarly relies on self-reports of cognitive processes such as “I check the accuracy of my cultural
knowledge as I interact with people from different cultures” (Ang & Van Dyne, 2008). The ability of people to accurately self-report on cognitive processes has long been questioned (Nisbett & Wilson, 1977). The measure of the motivational and behavioral elements is less problematic in this regard, but they are conceptually similar to items in the MPQ discussed previously and other measures of intercultural competence. This raises the question of the conceptual distinctiveness of these constructs and their incremental validity over existing measures. In fact, Ward, Fischer, Lam, and Hall (2009) found that these measures failed to show distinctiveness from a measure of emotional intelligence and did not explain additional variance in psychological, socio-cultural, and academic adaption over and above that explained by personality and emotional intelligence. Lee and Templer (2003, p. 208) in their contributed chapter to the Earley and Ang (2003) book make the following statements, “Any assessor who limits him or herself to only one assessment method is making a serious error and indeed may not actually be conducting an overall CQ assessment, but a rather limited measurement of a single attribute of CQ … As there is no one method that is effective in providing data on all aspects of an individual’s CQ, multiple assessment methods are a must if assessors are to develop a complete picture of CQ.” This sentiment does not seem to be represented in subsequent empirical work based on this model.

Following Earley’s (2002) seminal article, an alternative conceptualization of cultural intelligence was introduced (Thomas, 2006; Thomas & Inkson, 2003). Building on Earley’s idea (2002) and on Ting-Toomey (1999), this model was specified initially as “the ability to interact effectively with people who are culturally different” (Thomas, 2006, p. 80) and contained three elements of knowledge, mindfulness, and behavioral skills. This conceptualization was later refined by a multinational research team (Thomas et al., 2008a, p. 126), who defined cultural intelligence as “… a system of interacting knowledge and skills, linked by cultural metacognition, that allows people to adapt to, and shape the cultural aspects of their environment.” The distinctive features of this conceptualization are: (a) cultural intelligence is defined as a latent construct (Law et al., 1998) that exists at a higher level and emerges from the interaction of its constituent elements; (b) cultural metacognition occupies a central position involving both monitoring and regulation of cognitive activity; it influences the emergence of cultural intelligence through cognitive self-regulation, abstraction of specific knowledge, and focusing cognitive resources; and (c) the model does not specify a motivational or behavioral component (although motivation is implied in the regulation of cognitive activity and
appropriate behavior is in part the result of the skills component). The model is assessed through a multimethod tool presented through a web-based assessment. The assessment includes self-reports of cultural knowledge, evaluations of the cognitive complexity of this knowledge, self-reports of intercultural skills, and a process trace (in response to video stimuli) assessment of cultural metacognition (Thomas et al., 2008b). Both the theoretical conceptualization and operationalization are complex and may address some of the deficiencies in other articulations. However, empirical results are limited and a key feature, the emergence of cultural intelligence from the interaction of its constituent elements, has not been demonstrated. The challenges associated with the development and administration of sophisticated multimethod assessments has affected this effort, but according to some authors (Gelfand, Imai, & Fehr, 2008; Ward et al., 2009) this development is key to advancing the construct.

Comparison and Conceptual Similarities

A detailed outline of the differences in conceptualizations of cultural intelligence and global mindset has been presented in a previous edition of Advances in International Management (Earley, Murnieks, & Mosakowski, 2007), which I will not duplicate here. Rather, I identify the common themes that the three constructs represent with a view toward presenting opportunities for future development of a cognitive orientation in international management research.

The emergence of these three concepts is important for several reasons. First, all represent an attempt to identify an individual difference that will explain and predict individuals' effectiveness in a context that is now pervasive for organizations. Although all three have been applied to the group and organizational level (discussed ahead), they all have their foundations in the cognitive development of individuals. Second, they are all culture independent ideas. That is, they are indicative of cognitive development that is not tied to a specific cultural context. The implication of this notion is important in that individuals with varying levels of these concepts should be variably effective across cultural contexts. This is indicative of the kind of theorizing that moves us away from a reliance on cultural differences in values dimensions as a basis for understanding cultural influence in management (see Earley, 2006). Third, they are all multidimensional constructs. Multicultural personality is explicitly multidimensional, conceived as having five dimensions. Although some
definitions of global mindset have been one-dimensional, most contemporary conceptualizations include at least two dimensions. Cultural intelligence has been conceptualized as having three or four dimensions, with the dimensions variously reported as independent or interactive.

THE COGNITIVE REVOLUTION

More than 20 years ago, Prahalad and Doz (1987) recognized that the emergence of the modern multinational corporation required a sea change in our thinking, in which the cognitive orientations of managers took center stage. Now, this applies not only to multinational organizations, but to organizations of all types, as the concerns that applied only to large multinationals a few years ago now apply almost universally. Economic integration, the increased use and sophistication of information technology, and the introduction of new players on the international stage are creating a more complex, more integrated, and more dynamic organizational environment than ever before. In addition, as a result of low birth rates among established populations in the industrialized world and the concomitant increase in the proportion of immigrants, today’s workforce is increasingly culturally diverse. Thus, from both the strategic and cross-cultural perspective (see Levy et al., 2007a), the cognitive capabilities of managers is an important focus of international management research.

In a move away from a reliance on dimensional theories of cross-cultural variation, international management research is increasingly drawing on cognitive theory for insight linking culture to action (see Peterson & Wood, 2008, for a review). There may in fact be a cognitive revolution (Levy et al., 2007a) in international management research because of the ability of cognitive theory to provide links from cultural context to behavior. That is, cognitive theory provides integrated explanations of the processes that combine cognitive structures and social context to understand action (Wood & Bandura, 1989). As opposed to a reliance on dimensions of cultural variation for explanation of culturally different behavior, cognitive theory suggests that cultural differences in the cognitive structures that drive behavior are made salient at different times (e.g., Hong, Morris, Chiu, & Benet-Martínez, 2000). This recognition opens the door to the possibility that in addition to the development of cognitive processing preferences associated with the specific culture in which one grows up (e.g., Nisbett, Pehng, Choi, & Norenzayan, 2001) a more general development of cognitive structures and processes may occur that influences intercultural effectiveness.
Reflecting on this change in focus, a common element among the three constructs reviewed here is that they all focus on the cognitive development of individuals. However, if we are going to borrow from cognitive psychology, we must do so carefully, maintain the integrity of the arguments, and recognize limitations. For example, when values, motives, personality dimensions, or mental processes are central to our theory of understanding people’s basic characteristics or tacit assumptions, we must recognize limitations in the ability to consciously access these mental structures.

A second feature of the three constructs is that they all represent constructs that are independent of the cultural context in which they develop. By design the MPQ taps cross-situational consistency in multicultural effectiveness (van der Zee & Van Oudenhoven, 2001). Most definitions of global mindset implicitly (if not explicitly) define the construct in terms of dimensions that exist outside the specific cultural context in which they may have developed (Javidan, Steers, & Hitt, 2007). And both conceptualizations of cultural intelligence reviewed here specifically define the construct as unique and existing outside the cultural boundaries in which it developed (Ward et al., 2009). This sort of unitary culture-independent definition is not without its critics. For example, Berry and Ward (2006) suggest that this approach is likely to be plagued by the same kinds of conceptual, measurement, and empirical validations across cultures that undermine the use of the IQ construct cross-culturally.

Another common feature of the constructs reviewed here is that they are all multidimensional. As argued by Law et al. (1998, p. 741), “… a necessary condition for a multidimensional construct to be well defined is that the relations between the overall construct and its dimensions must be specified. Without a specification of these relations, one cannot derive the overall construct from its dimensions and can only conduct research at the dimensional level, even though these dimensions are claimed theoretically to be under an overall construct.” Unless this condition is met, theoretical specification of higher level constructs of multicultural personality, global mindset, or cultural intelligence loses its utility.

Moving Forward

With apologies to Paul Simon, if we want to feel groovy about these new ideas we need to slow down, we are moving too fast! This is not to say that a shift toward a cognitive focus in international management research should be slowed. On the contrary, I suggest that this is exactly the appropriate
direction to be taken if this research is to have relevance in the complex, geographically dispersed, and multicultural organizations of today. A continued reliance on studies of cultural dimensions does little to move us forward theoretically (see Earley, 2006). Likewise, the sheer number of intercultural competency measures available gives evidence to their lack of usefulness. What needs to be slowed down is the rhetoric about the utility of constructs such as those described here until the supporting science catches up. Of the three reviewed here, only multicultural personality seems to have avoided projecting its utility well beyond the empirical support. For example, in the recent edited volume on global mindset (Javidan et al., 2007), several of the chapter authors recognized the atheoretical nature of global mindset, the lack of a consistent definition, and the need for a valid measure to support the idea (Clapp-Smith, Luthans, & Avolio, 2007; Levy, Taylor, Boyacigiller, & Beechlar, 2007b; Javidan et al., 2007). However, this did not prevent authors in the same volume making sweeping prescriptions such as, “Corporate leaders are advised to develop, exhibit, and act with a global mindset for their firms to achieve and maintain a competitive advantage in international markets (Javidan et al., 2007, pp. 222–223).” The cultural intelligence literature is similarly afflicted with a propensity to overstate the case (e.g., Earley, Ang, & Tan, 2006; Thomas & Inkson, 2003). I say it is time for us (this author included) to scale back the rhetoric a bit and let the science catch up.

I suggest that in order for a construct representing individual differences in intercultural effectiveness to have utility in international management research, five criteria need to be satisfied. We need to know (a) what is included and what is not included in the construct; (b) the process through which these facets are developed in individuals; (c) if multidimensional, how these underlying facets combine to form the higher level construct; (d) the process through which the construct influences intercultural effectiveness; and (e) how this individual-level construct crosses levels to influence groups and organizations. In the following, I briefly expand on each of these issues.

First, the level of theoretical development of the three constructs described in this paper is highly variable. The atheoretical nature of the MPQ and global mindset has been mentioned previously. In contrast, cultural intelligence is significantly better developed in this regard. However, in this case, the inclusion or not of certain elements has been logically developed by different groups with reference to essentially the same literature. This has resulted in some theoretical tension between the two approaches. For example, the Earley and Ang (2003) conceptualization includes a motivational component that casts a positive (prosocial) halo
over the construct (Gelfand et al., 2008). However, Thomas et al. (2008a) contend that motivation is external to cultural intelligence (while some of their measures may belie this assertion) and acknowledge that cultural intelligence could be employed in the service of less than noble goals. Much needed discussions about the relative theoretical development of the two approaches are absent from the literature. Fundamental to establishing the validity of these constructs is the specification of what is and is not to be included and their relationship to effective intercultural interactions (Schwab, 1980). An underexplored avenue perhaps is an inductive approach involving an examination of individuals who have successfully operated in multiple cultural contexts. For example, biculturals, individuals who have internalized more than one cultural profile (Benet-Martı´nez, Lee, & Leu, 2006; Yoko Brannen & Thomas, 2010), may prove to be useful exemplars. That is, an understanding of the cognitive development of these unique individuals may help clarify the domain of the construct that allows individuals to successfully navigate multiple cultures (e.g., Tadmor & Tetlock, 2006).

With regard to the second criterion, the mechanisms for development of the constructs reviewed here are specified somewhat consistently. The MPQ, as with other similar inventories, has overriding concern for competencies related to intercultural effectiveness regardless of how they were developed. Cultural intelligence such as the early conceptualizations of global mindset (Govindarajan & Gupta, 2001) is specified as developing through social learning (Bandura, 1977) in an iterative experiential process (Thomas, 2006). Lee and Templer (2003) also rely on a social learning framework in the specification of training and development activities thought to be associated with each of the facets of cultural intelligence. And Nardon and Steers (2008) suggest experiential learning theory as a basis for understanding the development of a global mindset, which is largely consistent with the description of the development of the constituent elements of cosmopolitanism and cognitive complexity in Levy et al. (2007a).

Although there seems to be some consensus that the type of cognitive development being alluded to is developed through experience with culturally different others or in culturally challenging environments, additional clarity with regard to the type of development that takes place when individuals confront multicultural environments can be drawn from recent work in cognitive psychology. For example, when individuals are confronted with a new cultural context, the ambiguity presented by this situation causes them to engage in more active cognitive processing with regard to their cultural context (see Louis & Sutton, 1991) and in order to
resolve the dissonance created by this conflict they form new and more complex cognitive structures to resolve it (Festinger, 1957). Consistent with cognitive theories associated with acculturation (Tadmor & Tetlock, 2006), during the process of adjustment to a new cultural context, people may develop not only knowledge and the opportunity to practice behaviors, but higher order cognitive structures and processes through more systematic and careful processing of cues from cultural situations. That is, as individuals deal with new and conflicting information they acknowledge the legitimacy of competing perspectives on the same issue and form conceptual links among these multiple perspectives (Suedfeld, Tetlock, & Streufert, 1992). This process underlies the development of cognitive structures and processes that are not tied to the cultural context in which they were created. The importance of understanding this culture independent development cannot be overstated.

With regard to the third criterion, only the Thomas et al. (2008a) cultural intelligence construct is specific about the manner in which the various facets combine to form a higher level construct. Specifically, their view of cultural intelligence is of a latent construct that emerges through the interaction of its various facets. However, this relationship is untested. In contrast, Ang and Van Dyne (2008) indicate that cultural intelligence is an aggregate construct, but without specifying the method of aggregation. The MPQ (Van der Zee & Van Oudenhoven, 2001) is silent with regard to any combination of the various facets. The Levy et al. (2007a) conceptualization of global mindset indicates two factors, but while alluding to an information processing approach, it does not clearly specify the way in which the two facets interrelate. The Thunderbird Global Mindset Project (Hough et al., 2008) specifies global mindset as consisting of three dimensions, but no specification of the way in which the facets interrelate is presented. As suggested in Law et al. (1998), the meaning of a multidimensional construct is inexorably tied to the way in which its dimensions are interrelated.

The fourth criterion involves the process through which the construct influences intercultural effectiveness. Here, of course, is where the value of a cognitive development approach, as opposed to a dimensions approach, becomes most apparent. That is, by integrating the concepts of culture and cognitive processes we can propose constructs that link culture to action that transcends the simplistic “people from this (e.g., individualist) culture behave like this and from that other (e.g., collectivist) culture behave like that.” However, we must specify clearly the processes through which this occurs. For example, Levy et al. (2007a, p. 250) say that “… global mindset must be combined with the ability to define appropriate actions to take and
the ability to actually execute those actions,” but give little more in the way of guidance with regard to the relationship between global mindset and action. Thomas et al. (2008a) say that cultural metacognition is the linking mechanism between the various facets of cultural intelligence and that it functions to regulate cognition, abstract specific knowledge, focus cognitive resources, and compensate for individual differences in skills in determining culturally intelligent behavior. However, this specification falls short of developing testable propositions. Ang and Van Dyne (2008, p. 6) see behavior as one of the facets of cultural intelligence such that “behavioral CQ reflects the capability to exhibit appropriate verbal and nonverbal actions when interacting with people from different cultures.” The MPQ claims to measure multicultural effectiveness as opposed to dimensions that somehow result in effectiveness (Van der Zee & Van Oudenhoven, 2001) and thus avoids any discussion about how the underlying facets of cultural empathy, open mindedness, emotional stability, and social initiative result in effectiveness. In these later two cases, there appears to be some overlap between intercultural effectiveness and the specification of individual differences that somehow lead to intercultural effectiveness.

The final criterion is specified because of the context in which we as management scholars are concerned with the cognitive development of individuals. That is, it is the influence that this development has on work groups and organizations that we seek to understand and predict. Therefore, their utility is enhanced to the extent that we can specify the manner in which they cross levels of analysis. Much has been written on this subject (Chan, 1998; Klein, Dansereau, & Hall, 1994; Rousseau, 1985), which I will not discuss here, except to reinforce the view that international management is inherently a multilevel phenomenon that requires attention across levels of analysis (see Peterson & Thomas, 2007). Much background theory is available on which to draw, such as Triandis’ (1972) in depth description of how culturally different perceptions of the social environment influence norms, roles, and cognitive structures. An example pertinent to the constructs discussed in this paper is presented by Stewart, Fulmer, and Barrick (2005) in which they draw on role theory as a vehicle for crossing levels. Specially, they show how the role preferences held by individuals influence the role structure of the group, a higher level construct, and how this structure then relates to group performance. A parallel to this idea in which the cognitive development of individuals influences work group (top management team) structure and hence group performance seems possible. There are potentially numerous other opportunities to specify cross-level relationships pertinent to intercultural effectiveness at the group and organizational level.
CONCLUSION

In this paper, I reviewed three individual difference ideas that relate to a cognitive shift in international management research. They support an increasing focus on the cognitive development of managers, which promises to relegate dimensional approaches to understanding cultural influence and inventories of cultural competencies to the past. However, I suggest that for this cognitive revolution to take place these constructs must prove their utility by meeting five criteria. All of the constructs reviewed here meet some of the criteria outlined, but none meets them all. The idea of an individual difference construct that is independent from culture, but that helps to understand the ways in which individuals perceive and interpret culturally based contexts has tremendous appeal. In fact, without such an individual difference construct that explains and predicts variation in effectiveness in intercultural interactions, the future of the cognitive revolution in international management research is in doubt. Therefore, I believe we should rededicate ourselves to the hard work necessary to identify not only interesting but theoretically and methodologically robust constructs.

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REFERENCES


WALKING THE CULTURAL DISTANCE: IN SEARCH OF DIRECTION BEYOND FRICTION

Rian Drogendijk and Lena Zander

ABSTRACT

What we know is that the concept of cultural distance is frequently used, hotly debated and for many intuitively appealing. Suffering from a series of illusionary properties, it is argued to have outlived its usefulness. What we need to know is how to conceptualize the complexity of culture as a multi-dimensional, multi-level concept, taking context into account to measure quality rather than quantity (or distance). It is our ambition to do justice to the idea that cultural diversity not only leads to friction or problem creation, but also to enrichment and to generation of solutions. We discuss cultural conceptualizations and suggest cultural profiling and cultural positioning as alternative ways of comparing and contrasting critical cultural differences.

INTRODUCTION

Cultural distance has become so popular in international management research that Shenkar and colleagues describe it as an overvalued ‘must have’ in empirical analyses (Shenkar, Luo, & Yeheskel, 2008) and...
Harzing (2003) speaks of a resulting cultural ‘myopia’. The overwhelming majority of studies have employed the Kogut and Singh (1988) index to measure cultural distance. Since Kogut and Singh (1988) introduced their index of cultural distance, this is one of the most popular measures in international management research, even though its limitations are persistently pointed out. The concept of cultural distance has also been under much critique recently. Shenkar and colleagues (Shenkar, 2001; Shenkar et al., 2008) discussed the disadvantages or fallacies of the concept of distance for comparing groups of people, for instance nations, and their cultures and proposed that we substitute distance for ‘friction’. The main strength of the new metaphor is that it explicitly refers to the contact between, and the roles of, both sides of an inter-cultural encounter. In our point of view, however, the friction metaphor still triggers dichotomy-based thinking and focuses on negative consequences of cultural diversity. Below we plead for a conceptualization that does better justice to the complexity of cross-cultural comparison and interaction.

In this chapter, we explore alternative ways of conceptualizing, comparing and contrasting critical cultural differences in our empirical studies. Starting in the ‘past’ we will introduce what we know about culture distance research in international management as well as discussing the appeal, the illusions, and a recently proposed alternative to the distance metaphor. This will be followed by the ‘present’ and a section on what we need to know, where we take off into extant national culture research focusing in particular on its multi-dimensional, multi-level nature and context sensitivity. Moving to the future, we discuss ideas of how to conceptualize culture. To compare and contrast cultures we introduce ‘cultural profiles’ and ‘cultural positions’. We conclude with reflections on alternative directions for cultural research measures in international management.

THE PAST: WHAT WE KNOW ABOUT CULTURE DISTANCE

In this section, we will start with an introduction to the use of cultural distance in international management research. This will be followed by a discussion of the appeal and the illusions of cultural distance, before touching upon alternative measures and a recently presented metaphor to ground our discussions for the subsequent section of what presently needs to be done.
International management researchers have studied how cultural distance, understood as the cultural differences between managers’ or firms’ own and foreign national environments, affects managerial choices. A large stream of research has investigated the effect of cultural distance on firms’ market selection, entry mode choice decisions and international performance (for reviews see Harzing, 2003; Shenkar, 2001; and for a meta-analysis Tihanyi, Griffith, & Russell, 2005). Another significant research area has been the study of cultural differences in a relational perspective: the effect of cultural distance on international acquisitions, joint ventures and alliances, headquarters–subsidiary relations, and human resource management issues (e.g., Morosini, Shane, & Singh, 1998; Roth & O’Donnell, 1996; Gong, 2003). Others have investigated the role of cultural distance as a mediator or moderator of variables like international experience or relevant firm capabilities (cf. Cho & Padmanabhan, 2005; Reus & Lamont, 2009).

Given the abundant attention this construct has been given in the past three or more decades, it is striking that we are confronted with a lack of clear and consistent evidence for its effect on an array of dependent variables. Evidence of conflicting negative and positive effects of cultural distance has been piling up, leading scholars to talk about a ‘cultural distance paradox’. Notably this paradox seems to occur at different levels of analysis and across different research topics peaking researchers’ curiosity and ambition to resolve it. Brouthers and Brouthers (2001) address the cultural distance paradox surrounding entry modes choices, and by entering market risk into the equation they displayed that a culture–risk interaction could explain earlier conflicting results regarding entry mode. Another example is work by Wang and Schaan (2008) who found an inverted-U-shape relation between cultural distance, and entry mode and performance. In a meta-analysis of the effect of cultural distance on entry mode choice, diversification and MNE performance, Tihanyi and colleagues (2005, p. 278) go as far as to conclude, ‘cultural distance is not directly related to [these] three key constructs’.

Cultural distance studies have led to inconclusive results also in other areas of international management. For instance, the role of cultural distance in international acquisitions has been dubbed a ‘double-edged sword’ by Reus and Lamont (2009), as the effect of cultural differences on acquisition performance are both positive and negative. More specifically, cultural distance will increase learning under the wings of integration capabilities, but it also hinders development of such capabilities. Research on multicultural teams or work groups is also argued to generate
multi-faceted results (Thomas, 1999). Moving to the individual level, we find, for instance, work by Selmer, Chiu, and Shenkar (2007) who show that cultural distance does not unequivocally lead to expatriate adjustment problems. Managers bridge cultural differences, but results are contingent on the direction of the assignment, i.e., who works where. Moreover, Manev and Stevenson (2001) observed that although instrumental (work-based) networking functioned across cultural distances, this was not the case for the social interaction, which was based on similar cultural backgrounds.

In the large bulk of research on cultural distance’s impact on international management, we find considerable variation in topics and levels of analysis. We also find inconclusive results and attempts to resolve the national culture distance paradox, leading us to the question of why cultural distance has become such a staple in international management research.

The Appeal of Cultural Distance

The distance metaphor appeals to scholars because of its connotations with geographical distance and with psychic distance expressing remoteness and familiarity with foreign markets (Johanson & Vahlne, 1977). Not only has cultural distance led to a focus on differences as opposed to similarities. It also carries an explicit (or implicit) underlying assumption that cultural differences are the source of trouble (dismissing the potential positive effects of complementarities or diversity of cultural characteristics). Both research and abundant examples from practice pointed out to us that the crossing of cultures causes misunderstandings and liabilities and those are logically related to the differences between cultures, not the similarities.

When the foreign environment is ‘further away’ from our own, there are more (or larger) cultural differences between them, and it is likely that we have more difficulty understanding the other environment. After all, not all of culture can be seen, and much of it can only be investigated through experience or interpretation (Schneider & Barsoux, [1997] 2003). The ‘amount’ of differences then seems to connect logically to the amount of trouble: the more a culture is different to our own, the harder it gets to interpret behaviour and understand values of people from that culture. This also links neatly into ‘cultural fit’ arguments where a ‘fit’ is seen in a positive light and is assumed to happen when there are few cultural differences. Add to that the ‘what’s different is dangerous’ thesis and it is logical that we perceive differences in cultural contexts in terms of distance that should be overcome to achieve understanding, interaction and possibly appreciation.
Distance indeed can be overcome, or ‘closed’ as expressed by Shenkar, who without doubt captures the essence of the cultural distance concept when he points out that ‘the “distance” metaphor focuses on what sets cultures apart but not on what might bring them together’ (2001, p. 526). Subsequently, Shenkar (2001) proposes ‘closing’ mechanisms active at different levels, e.g., the global level (globalization, or more specifically increased communication and interaction that lead to cultures converging), the country level (geographic proximity), the firm level (foreign experience and staffing, in particular that of biculturals and third country nationals) and the individual level (acculturation and cultural attractiveness). These closing mechanisms add to the appeal and ease of understanding the ‘cultural distance’ metaphor. The appeal of the metaphor is in fact so strong that cultural distance has become a generic term, used either without any associated measures or based on other measures than Kogut and Singh (1988), often depicting cultural differences between individuals or team members in their interrelationship (e.g., Boyacigil, 1990; Thomas, 1999).

The Illusion of Cultural Distance

The development of an index of cultural distance by Kogut and Singh in 1988, based on the widely known culture dimensions of Hofstede ([1980]1984), spurred our use of the culture distance concept even further. The cultural distance index summarizes what is different between pairs of national cultures in a multi-dimensional space; the higher the result from calculating the distance between two cultures, the more differently they score on the respective dimensions included, in general. A particular index result, the distance between two cultures, does not inform us about which dimensions or characteristics are different, when they affect the relations between people from two cultures or how (cf. Shenkar et al., 2008).

Shenkar (2001) carefully outlines a set of conceptual illusions associated with culture distance starting with the ‘illusion of symmetry’, simply reminding us that ‘distance’ by definition is symmetrical. To this he adds an ‘illusion of stability’, that cultural distance is assumed to be constant although cultures change and multinational companies (MNCs) learn as they gain more internationalization experience. The ‘illusion of linearity’ refers to the assumption that culture has a linear impact on MNC investments and activities. The ‘illusion of causality’, implies that culture has a causal effect, and that it is the only relevant factor influencing MNCs. Finally, the ‘illusion of discordance’ refers to the assumption that any ‘lack
of cultural fit’ is critical to performance. In contrast, cultural differences can in fact be complementary.

The expression of distance suggests that the differences between cultures are perceived as similar, or that the respective cultural characteristics are perceived as similarly disturbing, by representatives of either culture. This falls within what is referred to as the ‘illusion of neutrality’ by Chapman, Gajewska-De Mattos, Clegg, and Buckley (2008), i.e., that cultural distance will have the same effects on action and interpretations of those experiencing it, with particular reference to historical and political events. Chapman and co-authors (2008) showed that cultural distance is relative: German and British respondents described the distance between their own and the Polish culture in different terms than the Polish respondents did with regard to the respective distance to the German and British culture. German and British respondents further gave diverse descriptions of the Polish culture, showing the effects of other contextual variables, like historical events, on the experience of cultural distance. Such contextual variables may affect the significance of cultural distance: small differences may matter much when the historical context between two cultures is characterized by negative experiences (cf. Chapman et al., 2008). The concept of distance diverts attention away from such contextual influences, and the literature therefore shows shortcomings in explaining how cultural differences matter and when (Leung, Bhagat, Buchan, Erez, & Gibson, 2005).

Another set of reasons for the messy understanding of cultural distance on international management relates to methodological properties of the concept of cultural distance itself. First, the distance concept ignores actual characteristics of cultures, whether they are expressed in thick ethnographic descriptions or in scores on value dimensions. In Shenkar’s (2001) view the cultural distance measure assumes both corporate and spatial homogeneity, thus discarding firm and intra-country cultural variance. The measurement of distance in a single index further zeroes out the variation in different characteristics and aggregates a multi-dimensional comparison of cultures into a single expression. The original Kogut and Singh (1988) index has not been updated with new dimensions and data. Furthermore, the assumption of equivalence (Shenkar, 2001) of the cultural dimensions included in the measure is challenged by research displaying that dimensions vary in their impact depending on what is being studied and in which context.

To this we would like to add what we call the ‘illusion of appropriateness’. The appeal of the ‘distance’ metaphor can partly explain Shenkar’s (2001) declaration that few constructs have gained such a broad acceptance in international management as cultural distance has. This has inevitably led to
culture seeking its way into areas, and studies, earlier void of such ‘soft’ reasoning. Suddenly, a complex difficult-to-grasp construct becomes easy-to-use, a questionable explanation turns into legitimate reasoning, and just by sheer number of applications culture distance turns into a taken-for-granted predictive variable. The cultural distance metaphor that Shenkar et al. denote as an overvalued ‘must-have’ is described by them as a ‘deceivingly simple way with which to conceptualize and measure key theoretical constructs’ (2008, p. 918). When discussing foreign direct investment research, Shenkar et al. (2008) stress the ‘metaphorical fit’ between these studies and cultural distance. Harzing (2003), reviewing entry mode decision research, goes as far as to argue that culture has moved from being neglected to an unwavering belief in the culture distance measure, which assumes myopic properties leading to systematic overestimation of culture’s influence. We posit that the cultural distance metaphor suffers from an ‘illusion of appropriateness’; it is appealing, it is applicable, it has gained legitimacy, in essence a ‘one-size-fits-all’ concept. Yet, with its conceptual illusions, neither the culture distance metaphor nor its measures have been left unchallenged. On the contrary, alternatives have recently been put forth.

Alternative Measurements and an Alternative Metaphor

Several authors have proposed and tested alternative measures of cultural distance, for instance, based on Schwartz’ 1994 dimensions (Brett & Okumura, 1998; Drogendijk & Slangen, 2006), or the GLOBE project (Reus & Lamont, 2009) or the perception of managers (Mjoen & Tallman, 1997; Evans & Mavondo, 2002; Drogendijk & Slangen, 2006). Although these are interesting exercises, employing alternative measures of cultural distance does not help overcome the disadvantages of the distance conceptualization. Björkman, Stahl, and Vaara (2007) leave cultural distance based on national cultural dimensions behind and propose a culture conceptualization based on interaction across cultural levels where beliefs, values and practices form specific cultural configurations embedded in particular contexts. This sounds promising in particular as a curvilinear impact is carefully outlined, yet the authors remain curiously tied to the idea that cultural differences (not similarities) is all about quantity (not quality) leading to negative (not positive) impact.

To surmount the liabilities of the cultural distance metaphor, Shenkar (Shenkar, 2001; Shenkar et al., 2008) introduced cultural ‘friction’ as an alternative metaphor. ‘Friction’ points to the clash between two cultures
with diverging characteristics and their carriers and to the disruptions that such contact leads to. Frictions are ‘subjective and socially construed’ and can change over time in the interaction between groups (Shenkar et al., 2008, p. 911). An advantage of using friction instead of distance as a metaphor of cultural differences is that friction explicitly refers to the contact between two sides of an inter-cultural encounter. This challenges research into the roles of both sides in international management encounters, for instance, foreign and local partners in joint ventures or expatriates and local employees in foreign units. Furthermore, whereas distance can be understood as an objective and fixed descriptive, friction opens up for the investigation of perceptions of culture and allows the encounters between cultures to change over time. Friction therefore does much more justice to the complexity of cultures and the interaction of their carriers.

However, friction is not a perfect solution as it still keeps us from seeing the positive effects of inter-cultural contact. It shifts our focus too much to dualities and the differences between cultures and does not give ground for studies of their similarities and how these may affect inter-cultural contact. Although Shenkar (2001) and Shenkar et al. (2008) point out that cultural differences can be complementary and have a potential for both disruption and synergy, this is not immediately apparent in their suggestion of ‘friction’ as an alternative metaphor. The prevailing focus on differences leads us easily to the study of clashes and animosities resulting from cultural differences and excludes the possibility that cultural differences hold advantages for international firms, teams as well as managers. The differences of cultures can, for instance, lead to enrichment or complementarities through increased variety in post-acquisition integration processes or global teams. Differences can also be perceived as attractive (Morosini et al., 1998). Shenkar et al.’s (2008) admirable attempt at formulating a substitute metaphor still falls short of taking contemporary culture research into account, in that studying frictions makes us ignore the actual cultural characteristics. In order to understand when, how and why cultures play a role in inter-cultural interaction in international management contexts, we will turn to the extant research on national cultures.

THE PRESENT: OUR UNDERSTANDING OF CULTURE AND WHAT WE NEED TO KNOW TO CONCEPTUALIZE AND COMPARE CULTURES

We initially touch upon our understanding of national culture in order to step away from cultural distance and friction metaphors to consider
alternative conceptualizations. Culture summarizes our values, preferences, attitudes and behaviours and is closely related to our identity. It is learned, that is, it is part of our social inheritance: we are educated in it by our parents, teachers, peers and other influential people as well as the sets of rules and routines of our near environment. Berger and Luckmann ([1966]1991) emphasize that primary socialization is necessary for understanding others around us and the world we live in as a meaningful and social reality. We tend to emphasize agreements within cultural groups and differences between them when comparing and distinguishing cultures. Such in-group versus out-group attitudes often results in the common use of stereotypes (Tajfel, 1982; Peabody, 1985). Stereotyping can be seen as unreflective unscientific simplifications of a complex reality. It is hardly surprising that national cultural distance similar to (and building on) Hofstede’s cultural dimensions have offered an appealing alternative: a simple, standardized tool, a convenient quantitative measure of a ‘soft’ concept to be used in combination with ‘hard’ data (Kogut & Singh, 1988; Shenkar, 2001). Yet, using cultural dimensions to describe and compare cultures can, according to Osland and Bird (2000), lead to a more ‘sophisticated stereotyping’ instead of an increased insight and understanding of other cultures. Although, culture is notoriously difficult to conceptualize (Boyacigiller, Kleinberg, Phillips, & Sackmann, 2003), we will discuss its multi-dimensional, multi-level context-sensitive properties in our attempts to move forward in a conceptual direction beyond ‘distance’ and ‘friction’.

Culture as a Multi-Dimensional Concept

Culture is a multi-dimensional concept: it covers a wide range of values, attitudes and behaviours and many researchers have tried to reduce this multitude to a limited number of dimensions that summarize human answers to central problems in life, e.g., people’s relations to other people, nature and time (Kluckhohn & Strodtbeck, 1961). Different (groups of) researchers have defined different (though often strikingly similar) sets of dimensions at the societal or national level. Especially the question of how people relate to other people has led to the identification of several cultural dimensions. Among the most important ones are individualism (often contrasted to collectivism), and the division of power between group members. The dimensions that have been used most often by international management researchers to describe differences between countries are those defined by Hofstede ([1980]1984, 2001): a review by Kirkman, Lowe, and Gibson (2006) found 180 studies covering a multitude of international
management topics. Alternative models or sets of dimensions were defined before his study (e.g., Kluckhohn & Strodtbeck, 1961; Parsons & Shils, 1951) as well as after (e.g., Trompenaars & Hampden-Turner, 1998; Schwartz, 1994; Maznevski, DiStefano, Gomez, Noorderhaven, & Wu, 2002; House, Hanges, Javidan, Dorfman, & Gupta, 2004).

Given our insights into culture as a multi-dimensional concept, we propose that we need a multi-dimensional rather than dichotomy-based concept to help us understand the interaction between cultures. We have already achieved much in this respect: researchers have distinguished multiple non-dichotomy-based dimensions of culture and several large empirical studies have confirmed and complemented each other (e.g., Schwartz, 1994; House et al., 2004). Earlier work by Kluckhohn and Strodtbeck (1961) emphasizing the co-existence of cultural dimensions, instead of the dichotomous nature as those defined by Hofstede ([1980]1984, 1991), have been re-measured by Maznevski and her colleagues (2002). In particular, certain dimensions have been corroborated by several of these studies: individualism and power or status division. Attempts to capture cultural phenomena in other parts of the world has led to the identification, conceptualization and measurement of new cultural dimensions (e.g., Chinese Culture Connection, 1987; House et al., 2004). More progress is needed here: in terms of discovering cultural variety and dimensions related to non-Western cultures, the African continent in particular is under-investigated. A starting point can be found in recently published work about the Ubuntu values (Mangaliso, 2001; Poovan, Du Toit, & Engelbrecht, 2006), but more inclusive and integrated investigations are needed to understand African (and other) countries’ cultural diversity and for discovering potentially new dimensions of culture.

Multiple Levels of Culture

It is well documented that culture affects people at many levels, ranging from the individual, to the group, organization and society levels, and that these levels interact dynamically to form and change culture (Leung et al., 2005). At more aggregate levels, culture is seen as the agreed upon and common values and behaviours of (groups of) people, and is thus more aggregate. Scholars have also identified inter-country cultural similarities leading to countries being grouped together in country clusters (Ronen & Shenkar, 1985; Gupta, Hanges, & Dorfman, 2002; Zander, 2005). In international management research, we refer most often to the national culture
level or country clusters; less attention is given to cultural characteristics at the individual, group and organizational levels. Research involving national cultural distance, however, has been carried out at all analytical levels.

The challenge is thus to include multiple levels of culture in our conceptualization. Culture at the level of teams interacts with culture at the organizational or even society level, and the interplay between these levels leads to intra-cultural diversity. Several authors have pointed to the existence of such diversity within nations and have challenged researchers to adapt their concepts and models to this reality (Lenartowicz & Roth, 1999; Au, 1999). Yet we need to learn more about how the levels of culture interact and how people as representatives interact, given the variation in levels of culture that affect them. It is likely that cultural differences at one level (e.g., in a team) are downplayed or enhanced by differences at another level (national). Other relationships, such as that between organizational and national cultures, have hitherto received more attention in the literature (e.g., Van Oudenhoven, 2001; Zander, 2002; Harzing & Sorge, 2003).

In a dialogue between five scholars in Alvesson, Yoko Brannen, Hatch, Jahoda, and Zander (2004), Zander puts forth that we as scholars often have a preference for and a focus on one cultural level in our research endeavours. This could be seen as a fundamental human reaction that simplifies the complexities involved in cultural study; however, it also isolates phenomena, which may thrive on multi-level interaction. Zander exemplifies how ‘perhaps other cultural sources are influencing the results, perhaps there are interaction effects across interrelated cultural sources, perhaps the study of values will be valueless and the study of meaning meaningless without the study of behaviour’ and so forth (Alvesson et al., 2004, p. 288). Even if understandably we may need to separate our objects of study to learn rather than ending up in blurred confusion at the end of the day, Zander seconds the multiculture proposition made by Sackmann and Phillips (2004), while adding the national cultural level to their multi-level perspective. Moreover Sackmann and Phillips (2004) emphasize that there is also a need to be aware of the research context as it might influence the data and the data collection process.

**Culture and Context**

It is clear that culture is embedded in a context in different ways. Culture is part of a system of interacting variables in the societal context, but it is also embedded in the particular situation in which it plays a role: a business
negotiation and a tourist visit are likely to lead to different inter-cultural experiences. We need to include both societal and situational context in our cultural analysis. To see culture in the context of specific practices and interactions is, according to Alvesson in Alvesson et al. (2004), one of the key elements in future culture research. With a systems view of culture we learn to understand the larger factors that interact with culture when it influences people and organizations, and interactions between them in a multicultural setting (Alvesson et al., 2004). Examples of such factors are globalization and factors related to economic development (Inglehart & Baker, 2000; Hofstede, 2001; Leung et al., 2005), language (West & Graham, 2004), political systems and historical events and processes (Hofstede, 2001; Chapman et al., 2008; Whitley, 1991). The cultural characteristics that play a role in a MNC headquarter–subsidiary relation can be very different from those that are important for international negotiations, or those that matter in teamwork. Taking context into account will help us to understand when which culture characteristics matter, and how. We also need to include context at lower levels of analysis: the particular international management phenomenon that we study and in which cultural interaction takes place, but also individual characteristics that affect the perception of cultural differences.

Culture furthermore relates to many other contextual variables affecting how people think and behave. At the level of the individual, sex and age are among culture’s covariates, whereas at the societal level factors like language, economic development, political system, educational system, religion, history, and even climate are found to co-vary with culture (Hofstede, 2001; House et al., 2004; Inglehart & Baker, 2000). Indeed, culture is a very complex concept because of its multiple and interacting layers, its multiple dimensions and its embeddedness in larger sets of contextual variables that affect human beings as individuals or in groups.

As an example of researchers grappling with the interaction and complexity, Redding (2008) is interested in the effects of culture on economic behaviour, in particular organizational and managerial behaviour at the firm level. He places his work at the societal level with the ambition to help us separate culture from institutions and to show how these interact. His approach is more contextual than multi-level and proposes using ‘semantic spaces’. The main idea behind the semantic spaces is to deal with complexity by focusing on a ‘space’ where specific action is carried out, e.g., eating or working in a factory. ‘Semantics’ refers to that culture is conceptualized as shared meaning, peoples’ attempts to make sense of their surroundings, which is ‘stored’, agreed and acted upon within a particular
semantic space. Actors move in and out of semantic spaces, sharing and affirming, they ‘know’ what is expected of them. Over time, with increased predictability, certain within-space cultural meanings (rules and norms) will become more tangible and venture outside the confined space into larger society (and organizations) in form of institutions.

To conceptualize and disentangle culture from institutions, and to understand how culture has an impact on organization and management, we need a concept that goes beyond a linear expression; a concept that allows us to compare cultures opens up for a multitude of cultural characteristics at different levels of the cultures compared. Researchers should be able to define the relevant characteristics of a culture given the empirical context they study, and include information on all these characteristics of the cultural groups involved. Both the contextualized cultural characteristics as well as a comparison between them for the pairs of cultures involved need to be included to help us discuss and investigate the effects of culture on international management.

**THE FUTURE: HOW TO CONCEPTUALIZE AND COMPARE CULTURES**

Given our understanding of culture as a complex and multi-faceted concept, it is surprising that we in the international management community have contended ourselves with the much more limited concept of cultural distance as an expression of the comparison between cultures. We have admittedly become aware of the restricted view that cultural distance as a concept offers on the influence of cultural characteristics on management and the relations between representatives of distinct cultures. Let us thus take the problems with the cultural distance concept and our understanding of national culture into account when we introduce and discuss ‘cultural conceptualizing’, ‘cultural profiling’ and ‘cultural positioning’ in the subsequent sections.

**Cultural Conceptualization**

In new conceptualizations of culture, we should allow for reflections of the similarities next to the differences between cultures. Cultural distance has in the past quite consistently led us in to a focus on differences and the problems they may lead to. Similarities, or cultural overlap, may help us understand other, perhaps positive, effects of culture on relationships in
international management. We should, however, take care not to understand cultural overlap as the opposite of cultural differences in that a large cultural overlap automatically results in good relationships. Neither should we understand cultural differences in terms of problems alone: Reus and Lamont (2009) showed empirically that cultural distance has both a negative effect on international acquisitions (through making integration more challenging) as well as a positive effect (through increasing learning opportunities). It is furthermore likely that international management relationships are influenced by ‘critical characteristics’ of culture, be they ‘critical differences’ or ‘critical similarities’; in other words, cultural characteristics that have a more substantial effect on inter-cultural situations than others (Zander & Zander, 2010). Finally, our conceptualization of culture should allow for the option that cultural characteristics complement each other or combine positively. The finding of a positive effect of cultural distance by Morosini et al. (1998) and later Reus and Lamont (2009) is likely the result of such processes of combination and complementarity that lead to a larger variety of ideas and options, but these studies cannot provide insights into which cultural characteristics combine, or how. There is very little research on the positive effects of culture, and it is therefore important that a conceptualization of culture stimulates this.

Another important step towards a better conceptualization of culture that is relevant for international management contexts is to include both the ‘descriptive’ as well as the ‘evaluative’ side of cultures. We can find inspiration in the work of Peabody (1967, 1985) who describes the character of a number of nationalities based on systematic studies of trait adjectives that make up stereotypes. Trait adjectives contain both objective (or descriptive) aspects and subjective (or evaluative) components. Peabody (1985) explains that the trait adjective ‘thrifty’ conveys the message that someone does not tend to spend money (a descriptive message), but also the evaluative judgment that that is good. The adjective ‘stingy’ would have expressed the same descriptive message, yet with a negative judgment attached to it. These adjectives show an evaluative contrast and they can be paired with adjectives that contain the opposite description that someone does readily spend money: the adjective ‘generous’ contains the positive evaluation, whereas ‘extravagant’ associates with a negative evaluation (Peabody, 1967). In empirical tests, Peabody showed that people were in agreement with regard to the descriptive aspects, but that judgment diverged with regard to the evaluative ones (Peabody, 1985). Furthermore, in-group judgments, i.e., descriptions of the own national group, tended to be more positive than out-group judgments. It follows that a conceptualization of
culture should take into account that there are descriptive differences between cultures that we can agree on, but that we still may need to gain insight into evaluative components in managers’ perceptions of their own and other cultures to arrive at a more complete picture of the intercultural contact. We realize that it will not be feasible to study such individual perceptions using every research design that intends to include the effect of culture, but that further work on the relation between the descriptive and evaluative judgments of culture may lead to insights into general patterns, and multi-dimensionality, which can be applied in related research.

We realize that walking the cultural distance in search of direction beyond friction is a daunting task. However, in the following sections we will introduce two attempts towards comparing and contrasting cultures: ‘cultural profiles’ and ‘cultural positions’. To conduct cultural profiling we propose the use of a multi-level process (Fischer, 2009) or the Kulturstandard method (Romani, Primecz, & Topcu, 2010). To carry out cultural positioning we put forth ‘culture positions’ (see Drogendijk & Holm, 2010) and ‘social attraction’ (Bogardus, 1926; Sinkovics & Penz, 2009).

**Cultural Profiles**

To compare and contrast cultures we need to ask ourselves what we are comparing. We have earlier argued the need for multi-dimensional, multi-level, context-sensitive conceptualizations of culture, and the challenge lies in achieving this while accumulating cultural knowledge for forming cultural profiles to be used for comparing and contrasting. It is difficult to design empirical studies that conceptualize and measure cultural characteristics at multiple levels of analysis. When thinking about multi-level research, Fischer (2009) asks how we can conceptualize culture as a collective-level phenomenon but measure it at the individual level, or use collective conceptualizations to explain individual level phenomena. He points out that to explain cultural effects on work behaviour, attitudes and management we need to span at least two levels simultaneously: the individual level and the cultural level in which the individual is situated. Fischer (2009) proposes a research process framework for planning new projects, based on recent advances in multi-level research especially on composition models, equivalence and isomorphism. Importantly, the research process is designed to measure culture as a ‘shared meaning process’ and a number of crucial steps to be aware of are outlined, if culture is to be treated as a shared construct (Fischer, 2009). In our cultural profiling attempts, Fischer (2009) provides us with a means for ‘unpacking culture’ at the individual level that
is to understand culture’s influence compared to alternative explanations (e.g., political or economic factors).

The *Kulturstandard method* (Thomas, 1988; Romani et al., 2010) offers us a way to identify cultural cognitive schemata of the persons involved, by analysing critical incidents that has occurred in their bicultural interaction. Romani et al. (2010) explain that ‘Kulturstandard’ captures the meanings of cultural ‘normality’, as in a common and shared way of thinking and acting. The authors prefer to stay with, and explain, the original German term, while others have chosen to translate it to what easily becomes misleading namely ‘culture standards’ (e.g., Fink, Neyer, & Kölling, 2006–2007). Kulturstandards are thought to provide more specific knowledge than what cultural dimensions can (Fink et al., 2006–2007), as what is perceived as a critical incident will vary across contexts. Methodological steps on how to arrive at Kulturstandards were described by Thomas (1988) and further developed by other scholars (e.g., Topcu, Romani, & Primecz, 2007). Romani et al. (2010) describe a method that starts with sample selection and interviews, followed by feedback from cultural experts in each culture about the other culture involved in the interaction. Highly frequent critical incidents indicating cognitive schemata are used to develop and validate Kulturstandards. Thus, culture is conceptualized as multi-dimensional and supported by historical, philosophical, and other country-specific contextual sources. An advantage of this method is its usefulness when carrying out bi-paradigmatic studies, e.g., paradigm interplay between positivist and interpretative investigations and analysis at a similar level of analysis. Where other bi-paradigm studies provide enriched analysis, Romani et al. (2010) stress that their proposed bi-paradigm interplay using the Kulturstandard method points towards new research questions and/or theoretical frameworks. We propose a dual use in that bi-paradigm rich knowledge is generated about two cultures simultaneously as both position themselves with the other culture in the critical incidents. The identification and validation of Kulturstandards is thus carried out for two cultures with respect to each other acting at a similar level and in a similar type of context but across differing cultures.

In our view, the two suggested approaches can be used in cultural profiling to plan and explore new knowledge as well as to re-evaluate, interpret and use extant knowledge in our attempt to create profiles of culture. These multi-dimensional cultural profiles will help us answer the questions of how, when and in what way culture has an impact on management and organization across levels and contexts. When we have established cultural profiles then the next question is how we go about comparing and
contrasting these. Having left both cultural distance and cultural friction behind us in our review of the past, we propose cultural positioning as an alternative direction into future research.

Cultural Positions

‘Cultural positions’ is a relevant concept for understanding the effect of culture on the relationship between two or more persons, groups or organizations (see the discussion started in Drogendijk & Holm, 2010). The concept encompasses both the actual cultural characteristics of the parties in a relationship, as well as the differences between them. It is thus both an absolute as well as a relative concept of cultural characteristics. It is therefore more appropriate for understanding the effect of culture on relationships than cultural distance because it overcomes the illusions of symmetry and linearity. Drogendijk and Holm (2010) support the importance of using the cultural positions of both sides in a relationship in an empirical study of headquarter–subsidiary relations. They compare situations in which the power distance acceptance of headquarters and subsidiaries diverges (i.e., there is large cultural distance) and find differences in the headquarter–subsidiary relationship, depending on whether it is headquarters that values power distance more, or the subsidiary. They further find that the situation in which headquarters and subsidiaries have similar preferences for high power distance (i.e., a small cultural distance) is different from the situation in which both units’ values reflect low power distance (i.e., also small cultural distance, but at the ‘other end’ of the dimension’s scale). Such results could not have been produced would their empirical test have been based on a measure of cultural distance, and support the call for studying both sides of the inter-cultural relationship (Drogendijk & Holm, 2010).

Many social psychologists have taken people’s perceptions of other cultures as the starting point for investigating the relations between cultural groups, without focusing on their descriptions of the other groups in terms of traits (as in the work of Peabody, 1967, 1985, discussed above). This stream of research is relevant for cultural positioning. It is based on Bogardus (1926) work on the perceived preferences or attraction between different groups in society, measured as people’s willingness to have social contact with people from defined other groups. Several contexts with varying degrees of close social contact are presented to respondents, ranging from being married to persons from the other social groups, to being friends, being co-workers or living in the same country. Respondents usually assess on Likert-type scales how comfortable they are with meeting people
from other groups in these various social contexts. Results of this approach inform us about attraction and aversion between social groups, or social categorization (Tajfel, 1982). Sinkovics and Penz (2009) adapted Bogardus’ social attraction scale to investigate the relation between residents and foreign tourists and employed a similarity analysis based on graph theory to analyse and illustrate the differences in the perceptions of Austrians with regard to Japanese and German tourists, respectively. In an exploratory study, Costa e Silva and Nardon (2009) compare the preferences of Portuguese managers to do business with their preferences to socialize with people from foreign cultures and they find striking differences with regard to the preferred nationalities in these two social contexts. Finally, the study of social identity in international joint ventures by Salk and Shenkar (2001) shows that people use different ways to identify themselves with social groups depending on the context they are confronted with, in the case of the study this could be the joint venture, the parent organization or the national culture of the people involved. Approaches like these, based on social psychological constructs, complement existing work because they focus on perception instead of objective distance and because they open up for the existence of attraction instead of frictions. Furthermore, we learn from social psychologists that the social context in which cross-cultural interaction takes place affects the perception of the people involved: for our perception of other cultures, and our attraction or aversion to them, it matters whether we interact in close daily contact in intensive teamwork or in teleconferences every other month, and whether we meet as friends, or in a business situation.

CONCLUDING REFLECTIONS

We have presented our search of direction beyond friction when walking the cultural distance for international management researchers in this chapter. We grounded our search in the valuable insights achieved so far by past research on cultural distance and continued with a discussion based on national culture research of the issues we need to deal with in our exploration. Finally, we have offered our suggestions for conceptualizing culture, profiling cultures and positioning cultures to increase our understanding of culture’s relevance for international management. Research based on the cultural distance metaphor has taught us that differences in terms of values, attitudes and behaviour affect people and organizations acting and interacting in a cross-cultural space, but has
focused mainly on the negative effects of cultural differences in international management. Although we agree with Shenkar’s (Shenkar, 2001; Shenkar et al., 2008) critique on the distance metaphor and its widespread use in international management research, we find it worth emphasizing that without this highly accessible and logically convincing concept and its measurement, we would have known a lot less. Yet, it is time to take further steps in developing a broader understanding of culture and how, when and why it affects international management phenomena. Shenkar et al.’s (2008) friction metaphor opens up for perceptions as the determining factor, and for change over time in inter-cultural encounters. However, it still focuses our attention on the dualities between cultures, and in this chapter we have therefore searched for alternatives that allow us to also include similarities, complementarities and attraction–aversion of cultures.

We propose cultural profiling and cultural positioning as alternatives to cultural distance. Both respect the characteristic of culture as a multi-dimensional, multi-level and context-dependent phenomenon. Cultural profiling aims at accumulating cultural knowledge at multiple levels, including the individual and a more aggregate level of culture, in order to compare, contrast and interpret how culture affects interaction of people. Analysing critical incidents, for instance an example of friction, using people’s perceptions as well as societal-level factors in order to explain them, leads to a multi-level understanding of culture’s effects in the selected contexts.

Cultural positioning is particularly relevant for analysing the effects of culture in relationships between people, organizational units, etc. Positioning shares the attention for both sides of the relationship with the concept of friction, but is more neutral with respect to whether the cultural characteristics included in an analysis are differences or similarities, leading to a negative or a positive experience. The context of the relationship defines perceptions of attraction or aversion on either side of it and we can investigate which characteristics or values play a role in the relationship.

Both profiling and positioning emphasize the importance of studying cultural characteristics at the level where they matter. In many international management phenomena, this means that we need to focus at the individual and its role in the organization rather than leaning on national-level data alone. This puts high demands and constrains on our research designs, and much of our research based on secondary, standardized data does not allow the study of the complete complexity of culture. In the following text, we share some ideas and thoughts about alternative ways of measuring or applying new conceptions of culture in research.
First of all, in contrast to prior focus on bipolarity and cultural differences, we could develop measures that capture cultural overlapping or similarities. Using the scores or rankings of cultures on one or more dimension studies, we could calculate shared surface of Venn diagrams expressing two or more cultures’ scores on multiple dimensions, next to studying the non-shared surface (or differences).

Also, in order to appreciate the multi-level characteristics of cultures, we could follow the examples of the approach of Fischer (2009) or the Kulturstandard method (Thomas, 1988; Romani et al., 2010), and use both quantitative and qualitative instruments to measure and analyse cultural profiles. And, as we also suggested above, we can build on social psychological methodologies for studying attraction and aversion between cultural groups and their representatives, which allows us to conceptualize and understand the role of culture in various contexts. Studying attraction and aversion furthermore helps us to understand how cultural differences may combine or complement to lead to a positive experience, and why this may be so in some contexts, but not in other.

In discussing potential research designs, as well as increasing the user friendliness of the extant cultural research, we found it helpful to consider the analogy of ‘Google Maps’ and its different features available to those searching information about a geographical location or landscape through the Internet. Like in Google Maps, we would want to be able to zoom out to form a broader impression from a landscape viewpoint, or zoom in to study a particular cultural characteristic in a particular context in detail. And similarly, we would like to choose to focus on the structural characteristics of a cultural landscape, its ‘topography’ or ‘infrastructure’, and also be able to choose the ‘satellite images’ option that shows the patchwork of the ‘use of land’ of the cultural landscape, and therefore provides a different description. Finally, just as in Google Maps, we would like to be able to select close-up views, e.g., of a particular inter-cultural encounter, by interactively specifying the characteristics of our search, and ‘walk’ though the cultural landscape of interest. These different features and perspectives allow us to develop our knowledge of cultures and cultural interaction in much more flexible ways than our focus on distance, or friction, can. It has been our aim, and contribution to the extant literature, to propose and discuss alternative, creative ways to conceptualize and measure culture, and to sort out their effects in international management through cultural profiling and cultural positioning. We realize that although our search has resulted in alternative directions beyond friction there is more ‘walking’ to do for scholars who nurture the ambition to move beyond cultural distance.
into the multi-dimensional, multi-level complexities of culture not only leading to problems but also allowing for enrichment and problem solution in international management research and practice.

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SOFTWARE, DISTANCE, FRICTION, AND MORE: A REVIEW OF LESSONS AND LOSSES IN THE DEBATE FOR A BETTER METAPHOR ON CULTURE

Brent Smith

Long ago, some anthropologists abandoned attempts to develop exhaustive definitions or taxonomies of culture that would enable baseline comparisons between countries and societies. However, social scientists in sociology, psychology, and management have contemplated that endeavor with unrelenting zeal. Since the landmark study of national culture by Hofstede (1980), scholars in these disciplines have seemed resolute in their intent to deterministically explain various settings, situations, and scenarios according to underlying, universally culture-specific characteristics (McSweeney, 2002). Hall (1976) regarded culture as a matter of context, whereas Hofstede (1994) viewed it as “the software of the mind” and “collective programming” of the people. Taking Hofstede’s quantitatively indexed national cultural values, Kogut and Singh (1988) advanced a notion of cultural distance implying that differences across cultural values were indeed measurable and meaningful.

While the idea of cultural distance has been highly adopted by management scholarship for more than 22 years, Shenkar (2001) and Shenkar, Luo, and Yeheskel (2008) have challenged its underlying assumptions and
appropriateness for the study of cross-cultural management. Instead, they contend that their metaphor of “cultural friction” is better fit to capture what happens when people of different cultures interact with one another. Outside of this debate, a variety of other metaphors have been used to describe situations, circumstances, and reactions to perceived cultural differences. These differences often involve home country versus host country issues impacted by national cultural values. However, such cultural values have been found to operate at the individual and interpersonal levels as well. Hence, as the field of study has been expanded to consider national and individual cultural values, debates have intensified regarding the most suitable metaphors to describe cultural differences.

This paper reviews various approaches for defining and conceptualizing culture, particularly through utilizations of metaphor. While most business scholars agree that culture plays an integral role in how people perceive, interpret, and react to the world around them, progress beyond this agreement could be stymied by a web of competing definitions. Recent debates suggest that there could be growing concern about the role and utility of metaphors intended to explain how cultural differences manifest between companies, consumers, and others.

The most salient debate brewing over cultural differences involves the usage of metaphors. Historically, these differences have been articulated in terms of distance. Within the last decade, however, some scholars (Shenkar, 2001) have faulted distance as a potentially misleading idea, despite and due to its underlying quantitative assumptions. While this debate dominates recent discussion on cultural metaphors, other metaphors – software, programming, collision, and friction – have added helpful and competing perspectives to the debate.

As natural consequences of debate, lessons and losses often ensue that ultimately help augment current knowledge. The debate over the “best metaphors” for culture and/or cultural differences is not immune to these consequences. Here, some directions for future research are presented that encourage earnest examination about the utility of old and new metaphors meant to inform management responses to cross-cultural issues. Additionally, a basic proposal is made to develop a mélange of past, present, and future metaphors into a “cultural metaphorscape,” which would acknowledge a pluralism of perspectives, affording much-needed flexibility in explaining various manifestations and interpretations of cultural differences. As cross-cultural scholarship slowly incorporates more ideas from non-Western and nontraditional scholars, the “cultural metaphorscape” can accommodate the anticipated diversity of accepted perspectives and knowledge (Peterson, 2007).
INTRODUCTION

Culture is important to many aspects of business life, especially when a business must interface with people, either as customers, employees, suppliers, or stakeholders.

– M. L. Jones (2007, p. 2)

The study of culture has typically been associated with the discipline of anthropology. Over time, social scientists have drawn upon the work of scientific and functional anthropologists like Tylor (1871/1958), Malinowski (1939/1944), Kluckhohn and Strodtbeck (1961), and others to develop their own conceptualizations of culture. These conceptualizations have played a major role in how business scholars examine culture’s impact on organizations and individuals. Generally speaking, these scholars agree that culture influences, or informs, how people observe, interpret, perceive, and react to the world around them. Given the diversity of culture’s manifestations and effects, scholars have produced many different definitions. In fact, over five decades ago, Kroeber and Kluckhohn had already cited 164 different definitions of culture (1952, pp. 43–55). Once separated by sacred and secular distinctions, culture was understood in somewhat nuanced terms. Tylor (1871) has been noted for early attempts to shift definitions of culture away from religious realms toward more secular, intellectual ones. Examples of definitions reflecting this shift are presented below:

- Edward B. Tylor: Culture is “that complex whole which includes knowledge, belief, art, morals, law, custom, and any other capabilities and habits acquired by man as a member of society.” (1871, p. 1)
- Clyde Kluckhohn: “By culture we mean all those historically created designs for living, explicit and implicit, rational, irrational, and nonrational, which exist at any given time as potential guides for the behavior of men.” (1945, p. 97)
- Clifford Geertz: “The culture concept ... denotes an historically transmitted pattern of meanings embodied in symbols, a system of inherited conceptions expressed in symbolic form by means of which men communicate, perpetuate, and develop their knowledge about and attitudes toward life.” (1973, p. 89)
- Louise Damen: “Culture: learned and shared human patterns or models for living; day-to-day living patterns. These patterns and models pervade all aspects of human social interaction. Culture is mankind’s primary adaptive mechanism.” (1987, p. 387)

Even amidst myriad definitions of culture, it is generally agreed that people of the same country, or nation, tend to accept or espouse a common
set of ideas, values, and beliefs that, for them, form culturally specific meaning systems (D’Andrade, 1984). These meaning systems arguably differentiate national cultures from one another over rather persistently over time (Hofstede, 1980). Aside from the definitions presented above, some cultural researchers have favored more explicit integrations of values, beliefs, and worldviews to explain culture. For example:

- Geert Hofstede: “Culture is the collective programming of the human mind that distinguishes the members of one human group from those of another. Culture in this sense is a system of collectively held values.” (1984, p. 51)
- L. Kroeber and Clyde Kluckhohn: “Culture consists of patterns, explicit and implicit, of and for behavior acquired and transmitted by symbols, constituting the distinctive achievements of human groups, including their embodiments in artifacts; the essential core of culture consists of traditional (i.e. historically derived and selected) ideas and especially their attached values; culture systems may, on the one hand, be considered as products of action, and on the other as conditioning elements of further action.” (1952, p. 181)

As noted by Peterson (2007), Hofstede (1980, 2001) accomplished a major feat in stimulating international organizational scholarship that involved culture. Essentially, he succeeded in producing a set of national dimensions of cultures and related scores that reflected the earlier functional theory scholarship of Inkeles and Levinson (1954/1969). Additionally, however, as Hofstede (1984) asserted a notion of culture as “collective programming,” he produced one of the first significant instances where culture was explained metaphorically in terms of instrumentality. Indeed, this metaphor reflected the position of Malinowski (1939/1944) that culture functions essentially as an instrumental apparatus whose every part is a means to an end. As is shown, cultural matters have been explained by a variety of metaphors whose underlying meaning can be linked to myriad sources.

CULTURE AND MANAGEMENT RESEARCH

Hofstede’s work became a dominant influence and set a fruitful agenda. There is perhaps no other contemporary framework in the general field of “culture and business” that is so general, so broad, so alluring.

– Malcolm Chapman (1997, pp. 18–19)
Debates ultimately help move scholarship forward. The debate over whether culture matters in international business and management is largely over. Scholars now generally accept that culture exists at the national, organizational, and individual levels. They also accept that culture can be manifested in both values and practices (see Hofstede, 1980, 2001; House, Hanges, Javidan, Dorfman, & Gupta, 2004). Culture has been linked to several issues in international management, such as entry mode, firm performance, and influence attempts in marketing channels.

Despite agreement that culture matters, cross-cultural scholars in the social sciences have many different views about how exactly culture operates (Tayeb, 2001; McSweeney, 2002; Hofstede, 2007; Singh, 2007). In some regards, these different views have garnered little attention. In certain cases, however, differences have spawned debates. Interestingly, some of these differences have been based on evaluations of metaphors used to describe culture and/or cultural differences.

### Metaphors for Culture

As noted above, Hofstede (1984) described culture as the “collective programming” of the group. By invoking comparisons to computer technology, this term reflected the instrumentality of culture argued decades earlier by Malinowski (1939/1944). Several other metaphors rooted in different contexts have been suggested. For example, Hofstede (1997) has compared culture’s layers to an onion. He has also described culture as the “software of the mind” repeating an association with computer science.

Following the landmark study of Hofstede (1980), business scholars and practitioners contemplated how the national culture index scores could, or should, inform decisions about a range of decisions, such as pursuit of foreign markets, interfirm partnerships, and hiring expatriate personnel. In a quest to make greater practical sense of Hofstede’s quantitative data that differentiated over 50 countries on four dimensions of cultural values, Kogut and Singh (1988) created an objective composite measure called cultural distance. Their concept and measure represented a major step forward for international and cross-cultural management researchers hoping to understand “the space” that existed between firms and people of different national origins. Their work has since dominated research concerning this space.

By some regards, the concept of culture distance provided an additional way to understand, or even envision, the situational context of two parties from different cultures. Hence, one could see cultural distance as the space
between the collective programming, or software, separating two parties from one another. However, not all scholars agree with the terminology or underlying concept of cultural distance. In fact, the fitness of the metaphor’s embedded logic has been challenged (Shenkar, 2001). Moreover, cultural friction (Shenkar et al., 2008) has been proposed as a replacement metaphor, rather than a complementary one.

Perhaps, as a worthy aside, practitioners in the field of cross-cultural management have also addressed cultural differences in a variety of ways. For example, renowned consultant and author Richard Lewis (2005) suggests that different cultures can actually “collide” or experience “friction” when they meet. In various circles, professionals have spoken of “bridging” cultural differences, which would suggest that such differences are comparable to cultural distances.

One finds a variety of perspectives spun into the complex web of metaphors used to explain culture and cultural differences. Whether these perspectives have been spun with clear intent or just haphazardly intertwined, the web is a functioning web nonetheless. To understand the utility of these metaphors and the practical value in comparing them, it is important to contemplate the role and purpose of metaphor.

METAPHOR: MEANING, LANGUAGE, AND DISTANCE

The term “metaphor” is derived from the Greek word *metapherein*, which means “to transfer.” Linguist George Lakoff and philosopher Mark Johnson define *metaphor* as “understanding and experiencing one thing in terms of another” (Lakoff & Johnson, 1980, p. 5). Essentially, metaphors serve the intended purpose of simplifying or explaining complex matters by using relatively more familiar or conceptually accessible terminology. In *Poetics*, the Greek philosopher Aristotle states: “Metaphor is the application of an alien name by transference either from genus to species, or from species to genus, or from species to species, or by analogy, that is proportion” (350 BCE, Section 3, Part XXI).

Lakoff and Johnson (1999) assert that metaphors are often utilized as instruments to cast “inference patterns from the source domain to the target domain” (p. 128). Aristotle surmised that metaphors can be effective within the continuum where concepts, or terms, share the same exact meaning or lack any underlying commonality. As a result then, metaphors would be
ineffective at either extreme. They are unnecessary in the former case and useless in the latter case.

Still, metaphor inherently has strengths and weaknesses, either of which tends to be contingent upon how mutually comprehensible the metaphor would be to author (sender) and audience (receiver). Hence, in some circles, the metaphor might be understood as a “double-edge sword.” Stern (1985) refers to this oft-overlooked issue as a matter of “semantic competence” possessed by anyone attempting to use or understand a given metaphor. Hamington (2009, p. 474) elucidates the potential problem: “Like an inside joke that only a select group of people understands, a metaphor is only effective if a common referent is utilized and that referent has unambiguous meaning. If someone were to say, ‘a resume is an income statement not a balance sheet,’ the audience must have a working knowledge of these business documents.”

Generally, metaphors are utilized to compare two concepts that are not fully alike, yet not substantially different. Consequently, the application of metaphors to different situations may expose, at some point, undesired “metaphoric residue” (Hamington, 2009). Some measure of residue naturally accompanies any utilization of metaphor; however, the significance of residue can intensify when audiences attempt to comprehend them with regard to major issues that require more clarity than gist. Furthermore, where competing metaphors exist to explain such major issues, diverse audiences are potentially exposed to increased risks of ignorance, embarrassment, or costly consequences thereof.

Clearly, metaphors or their underlying meanings are often rooted in specific cultural perspectives or languages. Hence, different people may conceivably associate different meanings with the same metaphors. Sapir (1958) suggests that language is inseparable from culture. Indeed, language and culture are instruments that may reflect one another in terms of a people’s underlying socialized values and vantages on life:

Human beings do not live in the objective world, nor alone in the world of social activity as ordinarily understood, but are very much at the mercy of the particular language which has become the medium of expression for their society. It is quite an illusion to imagine that one adjusts to reality essentially without the use of language and that language is merely an incidental means of solving specific problems of communication or reflection. The fact of the matter is that the ‘real world’ is to a large extent unconsciously built upon the language habits of the group. No two languages are ever sufficiently similar to be considered as representing the same social reality. The worlds in which different societies live are distinct worlds, not merely the same world with different labels attached … We see and hear and otherwise experience very largely as we do because the language habits of our community predispose certain choices of interpretation.

(Sapir, 1958, p. 69)
It can be gleaned from Aristotle (350 BCE) and Sapir (1958) that metaphor inherently represents a “slippery slope” for anyone attempting to explain one matter in terms of another, particularly when doing so across different languages and cultures. In light of the home versus host country perspective that has dominated international management research, it is possible that published scholarship has not adequately captured multicultural perspectives (i.e., language, culture, and metaphor) influence conceptualization of culture and interpretations of cultural differences. That is, has existing knowledge drawn from a sufficiently diverse range of the world’s cultural perspectives to deterministically address the following?

- Is culture like an onion or iceberg?
- Is culture comparable to software or programming?
- Are cultural differences synonymous with distance?
- When parties of different cultures interact, is there collision or friction?

These questions are important and will remain so given that most scholarship on culture and cross-cultural differences has been written and published in English. In limited cases, it has been translated from English into other languages. Lakoff (1987) contends that certain concepts are simply too difficult to translate or interpret properly into another language. For example, in American English often communicate times in relation to currency. Consequently, time can be spent, saved, conserved, or wasted. If this is the case with time, a concept seemingly universal to all people, what then abound for making sense of culture and cultural differences through a single metaphor?

**EVALUATING METAPHORS FOR CULTURE AND CULTURAL DIFFERENCES**

If you only have a hammer, you tend to see every problem as a nail.

Abraham Maslow

*Lessons and Losses*

International business and management scholars generally agree that culture plays a significant role in how organizations and people of different backgrounds perceive, interact, and react to one another. Yet, as discussed, culture and cultural differences remain very difficult concepts to pin down.
Given the confines of words themselves and the individual languages to which they belong, Sapir (1958) reminds us that words, such as metaphors, may be potentially useless or even confusing, when they are transmitted beyond their native language and underlying cultural meaning system. To this point, Hall (1966) contended that human beings cannot possibly divest themselves from any aspect of their respective cultures:

No matter how hard man tries, it is impossible for him to divest himself of his own culture, for it has penetrated to the roots of his nervous system and determines how he perceives the world ... people cannot act or interact in any meaningful way except through the medium of culture (p. 177).

Therefore, a first lesson extends from the wisdom Aristotle, Sapir (1958), and Lakoff (1987) that metaphors are grounded in cultural and language spaces. Consequently, beyond these spaces, metaphors may lose their effectiveness and fail their intended goals of simplifying complex matters. As a result, there may be no single best metaphor for describing or explaining cultural differences. Is it partially observable and partially hidden like an iceberg (Weaver, 1986)? Or, is layered and only perceptible when unwrapped like an onion (Hofstede, 1997)? Or, are these even the proper questions for understanding culture?

Looking forward, the existing metaphors that occupy the current landscape on culture should be examined. Today, the most prominent debate involves cultural distance and cultural friction. Lessons and losses can be associated with each metaphor and even the debate over which is superior.

* Cultural Distance versus Cultural Friction

The concept of cultural distance was presented just over 20 years ago by Kogut and Singh (1988) in their attempt to partially explain US firms’ choice of foreign entry mode – joint venture, acquisition, or greenfield investment. The measure of culture distance incorporated indexed scores for the four dimensions of national cultural orientation identified by Hofstede (1980). These dimensions included power distance, uncertainty avoidance, masculinity, and collectivism. Scores of studies (Benito & Gripsrud, 1992; Rosenzweig & Nohria, 1994; and many others) have gone so far as to adopt the mathematical formula or, at least, the basic concept of cultural distance to understand issues in international business and cross-cultural management.

The cultural distance metaphor has drawn upon and developed related concepts. Nearly 10 years ago, Johanson and Vahlne (1977) presented the
concept of “psychic distance” to which cultural distance is often associated as a synonym or subcomponent. Following Kogut and Singh (1988), the distance metaphor has appeared gradually in other contexts, such as knowledge distance (Farjoun, 1998), institutional distance (Kostova, 1999), and technological distance (Vassolo, Anand, & Folta, 2004).

One clear lesson from this expanding body of literature suggests, indeed, that the distance concept seems to make sense and, thus, fulfills a major objective of metaphor (Lakoff & Johnson, 1980). Moreover, since the distance metaphor has been diffused and adopted into other research streams, it has also fruitfully inspired new creative directions for research in general (Beyer, 1992; Cornelissen, 2005).

Despite its popularity, cultural distance has been criticized. Sousa and Bradley (2006) assert that cultural distance remains a poorly understood concept. Shenkar (2001) suggests that the cultural distance concept is neither adequate nor appropriate, reasoning that distance is of sterile flavor, too inflexible, and fails to account for change, evolution, or nonlinearity. Finding that the cultural distance metaphor has contributed to the descent of international management literature, Shenkar et al. (2008, p. 905) inquire:

But is ‘distance’ the appropriate metaphor with which to describe, analyze, and assess the impact of culture in IM (international management)? What are the underlying assumptions and potential biases associated with relying on distance as a primary metaphor, and how have those assumptions and biases impacted theory and research in IM? Is there an alternative metaphor that can better capture essence of the cross-cultural encounter as applied to international business phenomena?

As an alternative to cultural distance, Shenkar et al. (2008) suggest that cultural friction is a better metaphorical representation of situations that transpire when different cultures meet. Viewing an interaction of divergent interests, they argue that “substituting ‘friction’ for distance denotes shifting the emphasis from abstract differences toward contact between specific entities, onto the partisan concerns” (p. 911). Ultimately, they aim to “unveil the relationship between cultural and institutional environments” (McSweeney, 2002), which, to global strategy scholars, has been largely ignored or understudied in the cross-cultural management literature (Singh, 2007).

Shenkar et al. (2008) do acknowledge the possibility that their friction metaphor is limited. However, their acknowledgment falls short of addressing the underlying scientific context from which the metaphor is based. So, while distance has been criticized, it has, to its credit, also been replicated – psychic distance, cultural distance, knowledge distance, and
technological distance. Notwithstanding its introduction nearly a decade ago, the friction metaphor has yet to be adopted in the international management literature. Moreover, given friction’s origins in physics, a discipline relatively unlike management, how should scholars and practitioners make clear sense of friction’s applications to complex cross-cultural conundrums? For example, friction requires contact, but it is possible that parties may avoid contact as a reaction to perceived cultural differences. Furthermore, what kinds of objects – metal, wood, or glass – are comparable to particular cultures and what kinds of friction – static or kinetic; dry, lubricated, or fluid – are relevant to international management problems, such as market entry mode, negotiations, or multicultural sales force management (Smith, Larsen, & Rosenbloom, 2009)? These are valid questions for any utilization of metaphor. Furthermore, they speak directly to the issue of “metaphoric residue” asserted by Hamington (2009).

Where Shenkar (2001), Shenkar et al. (2008), and others see potential losses associated with the cultural distance metaphor, some scholars have taken a position that essentially marginalizes the distance versus friction debate. While most scholars generally agree with Hofstede’s metaphor of culture as “software” or “programming,” Singh (2007) argues that as an explanatory variable culture, and thus, cultural distance or cultural friction captures too little salient information to explain organizational behaviors within or between national cultures. In sum, Shenkar (2001), Shenkar et al. (2008), and Singh (2007) would suggest that cross-cultural and international management scholarship have been precipitously leveraged by a reliance on cultural distance. Singh (2007) would admonish further that even cultural friction provides little reprieve.

Metaphors for culture have been informative and instrumental to how scholars and professionals manage cross-cultural management issues. Hence, the debate of distance versus friction may be moot. Perhaps, one should debate whether there should actually be such a debate. Indeed, before this debate began, Hamilton and Biggart (1988) declared that it may not even be worthwhile: “[the] culture argument alone will not work well because … culture is a broadly based underlying cognitive factor that affects the society in general and for that reason explains nothing in particular.” (p. S73)

General Lessons and Losses

It is neither purposeful nor practical to debate the proven utility of metaphors in modern communication or management research. Metaphor
has and shall remain an integral part of how management scholars and business professionals convey ideas to colleagues and other audiences. Beyond the lessons and losses cited above, some additional potential lessons and losses should be considered.

Given the threats of “metaphoric residue” and meanings that may get “lost in translation” between different languages, management scholars must carefully consider the contexts from which they borrow certain concepts. Science and mathematics have provided the basis for many metaphors that have taken root in the business and management scholarship. This case holds especially true for culture, where social scientists have drawn from physics, computer sciences, and mathematics (see Table 1).

Possibly to the chagrin of some anthropologists, culture has been “metaphorically morphed” into terms involving software, programming, kinesis, collision, and ice formations. Hamilton (2009) contends that since “metaphors compare two unlike terms, there are usually aspects of the terms that are not alike and do not participate in helping explain the unknown” (p. 474). As we speak different languages across disciplines, one may inquire as to whether Leonardo da Vinci, Guillaume Amontons, and Charles Augustin de Coulumb knew that they were really studying how different distant objects in motion collide or experience friction? As metaphors from other disciplines are incorporated into international management, Maslow’s caution of “hammer and nail” should not be disregarded.

<table>
<thead>
<tr>
<th>Table 1. Source Contexts for Metaphors on Culture and Cultural Differences.</th>
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<tr>
<td><strong>Scientific Context</strong></td>
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<tr>
<td>1 Computer science</td>
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<tr>
<td>• Software</td>
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<tr>
<td>• Programming</td>
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<tr>
<td>2 Mathematics and geometry/geography</td>
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<tr>
<td>• Arithmetic distance</td>
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<tr>
<td>• Euclidean distance</td>
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<tr>
<td>• Physical distance</td>
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<tr>
<td>3 Geology</td>
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<tr>
<td>• Ice formations</td>
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<tr>
<td>4 Physics and engineering</td>
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<tr>
<td>• Collision</td>
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<td>• Friction</td>
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DIRECTIONS FOR FUTURE RESEARCH

Like Sapir (1958), Ching (1993) provides some insight about the underlying validity and significance of metaphors: “Metaphors raise consciousness to some state of affairs that already exist in our culture” (p. 45). Further, Hamington (2009) argues, “The metaphors we use do not always communicate a deeper structure of conceptualization, but they might. As business communicate their identity through vision and mission statements, organization charts, business plans, and ultimately culture, underlying metaphors should be observed and chosen carefully” (p. 482).

Taking these arguments along with lessons and losses associated with the cultural distance versus cultural friction debate, it would be fair to conclude that no single metaphor can fully capture the meaning of culture or the effects of cultural differences. Therefore, it is suggested here that developing a coalition of metaphors, a “toolbox,” so to speak, may be more appropriate and effective for accommodating various types of cultural scholarship.

In an effort to settle some debate over cultural scholarship’s present ground of contention (see Sun Tzu’s Art of War), the idea of a “cultural metaphorscape” is proposed. This new term is introduced to highlight the fact that current scholarship includes a growing panorama of metaphors positioned across the landscape (see Fig. 1). The “cultural metaphorscape” actively acknowledges any existing and future metaphors that could help inform managers about the nature of cultures and the possible kinds of cultural differences that could manifest between them in contract negotiations, market entry modes, customer relationship campaigns, cultural frame switching, and multicultural sales force management, for example.

The “cultural metaphorscape” acknowledges the very real challenges any single metaphor faces to minimize metaphorical residue (Hamington, 2009), increase mutual comprehensibility (Lakoff & Johnson, 1980), and fairly accommodate nontraditional/multicultural perspectives. Collectively, cultural metaphorscape acknowledge an evolving and expanding history of accepted metaphors – software, programming, distance, friction, collision, onion, and iceberg – that have provided clarity for some audiences and confused others. Surely, new and relevant metaphors are in the intellectual horizon. Clearly, the evolution of cultural scholarship within management has not occurred in a silo. Its evolution and its metaphors reveal significant inspirations from and interplays with the natural sciences, mathematics, and other disciplines. The cultural metaphorscape shifts the focus from a silo-oriented debate toward a broader, holistic, and pluralistic coalition of diverse thought.
Interestingly, while most management scholars agree that culture plays a vital role in influencing how people affect and are affected by the world around them, they are stymied by a web of definitions, metaphors, and research findings regarding culture. Metaphors, the focus of this paper, have been instrumental in evolving and expanding cultural scholarship over the last few decades. Within the last 15 years, this growth has been marked by debates about the utility of various metaphors intended to reflect the meaning of culture and role of cultural differences. These debates have been
expressed largely as critiques of the distance metaphor (e.g. cultural distance). These critiques have been expressed most vigorously by Shenkar (2001) and Shenkar et al. (2008) in prominent international business and management journals.

In this paper, it is the position that metaphors are themselves grounded in the culture and language of those that create them and communicate with them. Consequently, lessons and losses can be realized in the adoption of metaphors to cross-cultural scholarship. Furthermore, given that the prevailing metaphors, such as distance, friction, software, programming, and others, are grounded in other disciplines, scholars face an uphill challenge in defending any such metaphor as perfectly comprehensible to all and entirely free of “metaphorical residue.” So, in keeping with the evolved perspectives on Earth, which has been “correctly” called flat, round, or spherical at one time or another by scientists, some openness should be afforded to different metaphors for cultural.

Acknowledging the evolution and diversity of perspectives on cultural issues in international management, the “cultural metaphorscape” values the variety of past, current, and future metaphors that can help people understand the nature, properties, and results of cultural differences. The metaphorscape acknowledges the idea that metaphors themselves can represent underlying cultural differences about how people understand and operationalize around the world. As a result, the “cultural metaphorscape” represents an open-source tool available to scholars beyond the European and North American perspectives currently dominating the field. As scholars from nontraditional backgrounds gradually contribute more knowledge to cross-cultural scholarship, there must be a ready and open-minded community to welcome that knowledge (Peterson, 2007).

REFERENCES


THE LIABILITIES OF ORIGIN: AN EMERGING ECONOMY PERSPECTIVE ON THE COSTS OF DOING BUSINESS ABROAD

J. Ramachandran and Anirvan Pant

ABSTRACT

We contend that the concept of liability of foreignness is inadequate to describe the set of disadvantages faced by emerging economy multinational enterprises (MNEs) in international markets. In order to address this theoretical gap, we develop the concept of “liabilities of origin” (LOR). We propose that the concept of LOR explains how the national origins of the MNE shape its disadvantages in international markets through three distinctive contexts of the MNE’s ongoing activity: the home country context, the host country context, and the organizational context. We argue that in order to understand how emerging economy MNEs overcome their LOR, we need to engage simultaneously with the theoretical perspectives provided by the institutional entrepreneurship and organizational identity literatures. We suggest, further, that the concept of LOR may be useful to understand the character of MNE disadvantage in any international foray where the national origins of the MNE engender legitimacy-based and capability-based disadvantages for the MNE in a host country.
INTRODUCTION

The intimate coupling of advantage and disadvantage is central to the conceptualization of the multinational enterprise (MNE) in International Management (IM) research. The acknowledgement of this simultaneity in the theory of the MNE goes back to Hymer (1960, p. 6), who juxtaposed the “barriers to international operations” faced by firms in foreign markets with their “possession of advantage as a cause of international operations.” The ownership advantage possessed by the MNE, argued Hymer, helps the MNE counteract the disadvantages inherent in foreign operations and encourages the MNE to control foreign assets and appropriate fully the returns on their business. Over the years, Hymer’s insight has provided the anchor for theorization on MNEs. For example, in an articulation typical of the literature, Buckley and Casson (1998, p. 540) noted that the MNE “must possess a ‘compensating advantage’ in order to overcome the ‘costs of foreignness.’” However, while Hymer had drawn attention to the disadvantages of multinationality, his focus was on understanding the nature of the advantage possessed by the MNE that made foreign direct investment plausible. This set the tone for IM research in subsequent years as researchers dwelt on the nature and deployment of the proprietary advantage(s) possessed by MNEs while paying scant attention to the nature of the disadvantage(s) faced by MNEs and its consequences for their internationalization strategy (Cuervo-Cazurra, Maloney, & Manrakhan, 2007; Mezias, 2002a; Zaheer, 2002). As Eden and Miller (2001, p. 1) note, these disadvantages or “costs” have, by themselves, “received less attention, serving primarily to motivate research on the MNE’s advantages.” The costs of doing business abroad remained “an assumption largely unexamined among researchers working on theories of the multinational enterprise” (Zaheer & Mosakowski, 1997, p. 439).

It was Zaheer’s work on the liability of foreignness (LOF) (Zaheer, 1995; Zaheer & Mosakowski, 1997) that helped redirect attention toward the disadvantages of MNEs in foreign markets. Since then, a significant stream of literature has emerged in IM that has examined the incidence and consequence of LOF and explored strategies for overcoming LOF (Miller & Eden, 2006; Kostova & Zaheer, 1999; Kronborg & Thomsen, 2009; Mezias, 2002a, 2002b; Miller & Parkhe, 2002; Nachum, 2003, 2010; Zaheer, 1995, 2002; Zaheer & Mosakowski, 1997). Separately, Cuervo-Cazurra et al. (2007) have presented an overarching exposition of the disadvantages of firms in foreign markets. Research in this literature, however, has failed to engage with the implications of the rise of a new wave of MNEs based out of...
We could locate no research articles that explicitly study the incidence of LOF for the subsidiaries of emerging economy MNEs (EE MNEs). As a contribution to the conversation on the “Past, Present and Future of International Business and Management” in this volume, we thought it appropriate to propose an in-depth engagement with the nature and character of the broader set of disadvantages borne by EE MNEs during their internationalization journey. Such an engagement, we believe, is essential to acquire a more comprehensive understanding of the disadvantages, in general, that are experienced by MNEs in foreign markets.

We present three principal arguments in this paper. First, we argue, with particular reference to the concept of LOF, that the disadvantages of EE MNEs have been inadequately attended to in the IM literature. Second, we propose that scholars in IM need to complement the insights provided by LOF with the origin-driven disadvantages of EE MNEs. We call these complementary disadvantages the liabilities of origin (cf. Bartlett & Ghoshal, 2000) and argue that the mechanisms underlying LOF and the liabilities of origin are very different. Third, we suggest that the literatures on institutional entrepreneurship and organizational identity may be useful to understand how EE MNEs overcome their liabilities of origin. It must be noted that although the liabilities of origin are most salient, in contemporary times, in the case of EE MNEs, such disadvantages can, arguably, be borne by any MNE.

The paper is organized as follows. In the next section, we examine the thrust of the IM literature on EE MNEs. Next, we review the extant literature on disadvantages faced by MNEs in general in international markets, dividing these disadvantages into two types – the LOF and the liability of multinationality. We proceed, in the following section, to argue that firms can suffer from a third distinctive category of disadvantage in international markets, which we label the liabilities of origin. We propose, furthermore, that the liabilities of origin are disadvantages faced by MNEs in international markets as a consequence of their national origins and that these disadvantages are emanate from three interrelated contexts of MNE activity – the home country context, host country context, and the organizational context. In the subsequent section, we present a detailed examination of the conceptual differences between LOF and the proposed liabilities of origin. Finally, we suggest that the institutional entrepreneurship and organizational identity provide useful theoretical frames for understanding how the liabilities of origin can be overcome at a firm level.

The arguments in this paper are bound by three presumptions. One, in spite of substantial differences between the institutional environments of
different emerging economies, it is possible to meaningfully talk of the common disadvantages of EE MNEs. Two, the terms (relative) “costs” and “disadvantages” can be used interchangeably even though the former would, logically, precede the emergence of the latter. Three, the character of the liabilities of origin can be best explained by focusing on the case of EE MNEs seeking to enter developed economy markets and that the liabilities of origin would be most pronounced in this case.

EMERGING ECONOMY MULTINATIONAL ENTERPRISES

Although research on emerging economies as an arena of IM research has increased dramatically in the past decade, this literature has been largely preoccupied with the experience and performance of developed economy MNEs entering into emerging economy markets. Notwithstanding intermittent calls for research that furthers our understanding of the internationalization of MNEs originating in emerging economies (e.g., Wright, Filatotchev, Hoskisson, & Peng, 2005; Yeung, 1999), there has not been substantial progress in this direction. As Peng, Wang, and Jiang (2008, p. 938) observe, “Given [the] traditional focus on MNEs from developed economies, we currently know very little about how firms from emerging economies internationalize.”

In the 1970s and 1980s, MNEs emerging out of developing countries were viewed as deviants from conventional MNEs from developed economies (Yeung, 1999). The early literature on the so-called Third World Multinationals (Lall, 1983; Lecraw, 1977; Wells, 1983) extended Vernon’s Product Life Cycle model to explain how these MNEs adapted products and technologies to demand and factor conditions in other developing countries. This hypothesis was unsettled by the East Asian MNEs of the 1980s that were able to establish sales and manufacturing operations in developed economies. This led, eventually, to a revision acknowledging that the competitive advantage of these MNEs lay in path-dependant capabilities of product development entailing “innovation on essentially different lines” (Tolentino, 1993, p. 77; see also Lall, 1998).

More recently, the sustained high levels of economic growth witnessed by a subset of developing economies – the emerging economies – and the increasing prominence of MNEs originating in these economies, has revived academic curiosity about the nature of EE MNEs. A number of articles have
appeared seeking to explain the growth of EE MNEs from an advantage perspective and comparing their advantages to those of developed economy MNEs (Chittoor, Sarkar, Ray, & Aulakh, 2009; Cuervo-Cazurra, 2007; Gubbi, Aulakh, Ray, Sarkar, & Chittoor, 2010; Guillén & García-Canal, 2009; Luo & Tung, 2007; Mathews, 2006; Miller, Thomas, Eden, & Hitt, 2008; Ramamurti & Singh, 2008; Yang, Jiang, Kang, & Ke, 2009). Largely, these articles emphasize commonality in the competitive advantage of internationalizing EE MNEs. For example, Mathews (2006) has presented his Linkage-Leverage-Learning model as an alternative to the OLI paradigm and as one that, he argues, better explains the fit between EE MNEs and the changing exigencies of the global economy (see also Narula, 2006). Luo and Tung (2007) have argued for a “springboard perspective” on EE MNEs that characterizes their internationalization process as aggressive and risk-taking and aimed at acquiring strategic assets in developed countries in order to compensate for their late mover status. On the other hand, Ramamurti and Singh (2008) emphasize variety in the bases of competitive advantage of EE MNEs and identify four generic internationalization strategies for EE MNEs – local optimizer, low cost partner, global consolidator, and global first-mover.

Although it is important to examine the bases of the advantages possessed by EE MNEs, it is equally important, indeed critical, not to gloss over the disadvantages faced by EE MNEs in foreign markets as these may enhance substantially our theoretical understanding of EE MNEs and, indeed, of multinationality in general (cf. Cuervo-Cazurra & Genc, 2008). Competitive disadvantage is not just the “dark side of competitive advantage”: they are independent and may exist simultaneously (Powell, 2001, p. 877). The simultaneity of advantage and disadvantage in the theoretical conceptualization of the MNE makes it incumbent upon us to be equally heedful to the bases and characteristics of both in order to acquire a well-grounded understanding of the phenomenon represented by the rise of EE MNEs. It is generally acknowledged that firms from emerging economies face substantial disadvantages when they venture outside their home countries and seek to compete in international markets (Cuervo-Cazurra & Genc, 2008; Luo & Tung, 2007; Thomas, Eden, Hitt, & Miller, 2007; Wright et al., 2005). Unfortunately, in keeping with the traditional IM overemphasis on the nature of advantage of MNEs, most research on EE MNEs seems content to use the notion of disadvantage of EE MNEs merely to initiate a discussion of their advantage in international markets. In this paper, we focus exclusively on the nature of the disadvantages borne by EE MNEs and develop the concept of liabilities of origin as a complementary concept that,
along with the extant conceptualizations in the IM literature, serves to more adequately represent the disadvantages in international markets of EE MNEs.

THE DISADVANTAGES OF MNES IN INTERNATIONAL MARKET

The term “costs of doing business abroad” (CDBA) has been used as an all-encompassing term for all the disadvantages that firms face in foreign markets, either relative to the advantages held by local firms in the foreign market or relative to their domestic operations (Eden & Miller, 2001). CDBA has been used to denote the barriers to international operations discussed in the literature from Hymer (1960) onwards although the phrase itself seems to have been coined by Aliber (1970). The term was employed thereafter in IM research as a point of departure for discussions about the MNE’s need to possess compensating advantages in foreign markets. Zaheer (1995) coined the term “liability of foreignness” and triggered off a stream of research that focused directly on the nature and implications of the MNE’s disadvantages. She acknowledges that while she had initially regarded LOF as “closely related if not synonymous with” CDBA, she has come to regard LOF as a distinct conceptualization with its center of gravity in the institutional distance that the MNE has to bridge in order to operate in a foreign country (Zaheer, 2002, p. 351).

Liability of Foreignness

Zaheer pointed out that there were long-lasting structural/relational and institutional costs of operating in host markets that were borne by foreign subsidiaries that had not yet gained access to local information networks and customer bases – at parity with local firms – nor yet established their legitimacy with the institutions in the host country (Zaheer, 1995, 2002; Zaheer & Mosakowski, 1997). These costs, potentially borne by any entrant into a foreign market and reflecting the foreign firm’s interactions with the host country environment, constitute the LOF. Metaphorically, the concept of LOF evokes the notion of the “stranger in a strange land” with its connotation of two-way unfamiliarity between the host country institutional environment and the foreign subsidiary (Eden & Miller, 2001).
There is a clear continuity between the early understanding of CDBA and the recent literature on LOF. For example, Hymer (1960), Caves (1971) as well as Carlson (1974) had referred to the information costs borne by the foreign firm that have recently been revisited in the LOF literature. Seeking to distinguish LOF from CDBA, Eden and Miller (2001, 2004) assert that LOF should be viewed as the social cost component of CDBA and that it comprises only the costs borne by the subsidiary, either as a consequence of unfamiliarity with the host country environment, or as a consequence of discrimination. Among the components of LOF, information costs and low institutional familiarity are expected to be less severe and more transient as compared to the costs of discrimination by host country governments, customers, and suppliers that are borne by foreign subsidiaries (Hymer, 1960; Zaheer, 1995).

An indicator of the potential LOF that a firm will face in a foreign market is the firm’s institutional distance – captured in terms of Scott’s (1995) cognitive, normative, and regulatory domains – from the said foreign market (Zaheer, 2002). High institutional distance has, broadly speaking, two sets of consequences for the foreign subsidiary. First, it highlights the (high) level of experiential learning the foreign subsidiary must acquire in the host country. Eriksson, Johanson, Majkgard, and Sharma (1997) divide these “costs of lack of experiential knowledge” into foreign business knowledge (of clients, markets, and competitors) and foreign institutional knowledge (of government regulations and the more tacit institutional rules and norms). Cuervo-Cazurra et al. (2007, p. 719) observe that the “understanding, relationships and social capital needed for dealing with other entities and prevailing rules of behavior” constitute valuable complementary resources needed by entry-seeking MNEs for competing in a new institutional environment. This point is also emphasized by Johanson and Vahlne (2009) who use the term “liability of outsidership” to denote the debilitating consequences of the foreign firm’s lack of relationships and network membership in the host country environment. Second, high institutional distance also suggests a significant deficit of legitimacy in the host country. As Zaheer and Mosakowski (1997, p. 461) observe, “There is an implicit, dynamic relationship between the liability of foreignness and the legitimacy of foreign firms in different cultural and institutional settings.” The low legitimacy of foreign subsidiaries is reflected in the discrimination vis-à-vis local firms they face in their dealings with host country constituents. Evidence has been presented in recent research for a relationship between LOF and a variety of adverse consequences for subsidiary operations in the host country including lower efficiency of
operations relative to local firms (Miller & Parkhe, 2002), lower survival rates (Zaheer, 1995; Zaheer & Mosakowski, 1997), greater incidence of labor lawsuits (Mezias, 2002b), and poorer innovation outcomes (Schmidt & Sofka, 2009).

Calhoun (2002, p. 305) observes, “What seemingly lie at the heart of every discussion of liability of foreignness ... are the costs that cannot be easily anticipated and that may continue for an indeterminable time in an indeterminable amount.” How, then, can subsidiaries tackle LOF? Apart from pointing toward the benefits of gaining experiential knowledge in the host country over time, research on LOF offers two, somewhat contradictory, responses to this end – conformity to local institutional pressures and differentiation based upon firm specific advantages. Conformity to local institutional pressures can enhance the legitimacy of the subsidiary by making it more comprehensible and taken-for-granted (cf. Suchman, 1995). However, the “tacit, country-specific nature of institutional norms” (Luo & Mezias, 2002, p. 218) makes it difficult, first to identify, and then to implement the accepted practices (Calhoun, 2002). On the other hand, it has also been argued, “firm-specific advantage, as embodied in important organizational practices may be a more effective way for multinational enterprises’ subunits to overcome the liability of foreignness than imitation of local practices” (Zaheer, 1995, p. 360).

In sum, the essence of LOF lies in the disadvantages of the foreign subsidiary relative to the local firm. This is highlighted in Mezias’ (2002a, p. 268) definition of LOF: “Costs only foreign firms incur when operating abroad, costs foreign firms incur disproportionately to domestic firms, and benefits denied to foreign firms that are enjoyed exclusively by domestic firms.” LOF is, thus, always relative to the experience of the local firm and is expected to decline over time as the subsidiary gains a better understanding of the host country institutional environment, enhances local legitimacy, and secures access to local information networks.

Liabilities of Multinationality

Although the disadvantages of MNEs relative to local firms in foreign markets are captured in terms of LOF, there are other disadvantages that are intrinsic to the act of owning and managing operations across borders and can only be comprehended relative to the costs of domestic operations.
These costs are conceptually distinct from LOF and we use the term “liabilities of multinationality” (Zaheer, 2002, p. 354) here to denote these costs.

The liabilities of multinationality are the complexity and coordination costs inherent in multinational operations and incurred right from the initiation of cross-border activities. One of the barriers to international operations mentioned by Hymer (1960) – the foreign exchange risk – signifies a liability of multinationality and not of foreignness. Costs of coordination were recognized early on by Kindleberger (1969) and Vernon (1977). Kindleberger (1969, p. 12) observed that the “costs of operating at a distance” implied that local firms have the advantage of “being nearer the locus of decision-making and without the filter of long lines to distort communication.” The liabilities of multinationality also denote the costs of managing the parent–subsidiary relationship, the multinational network of subsidiaries and affiliates, and interactions with transnational institutions (Eden & Miller, 2001; Sethi & Judge, 2009). The MNE’s inability to transfer (parent-held) firm-specific advantages to the subsidiary (Cuervo-Cazurra et al., 2007) constitutes another aspect of the liabilities of multinationality.

Disadvantages flowing from costs inherent to multinational operations should not be confused with the LOF because their existence cannot be defined with respect to the advantages of local firms in the host country; they can be perceived only in terms of a comparison vis-à-vis the costs of domestic operations of the entry-seeking foreign firm. Furthermore, it is our view that the notion of liabilities of multinationality is most useful if it is seen to be borne primarily at the level of the MNE headquarters and not at the level of the subsidiary (cf. Sethi & Judge, 2009). The incidence of the different aspects of the liabilities of multinationality are antecedent to the subsidiary’s ongoing engagement with the specific host country environment and affect, directly, the strategic choices made by the headquarters. As the liabilities of multinationality correspond to the act of internationalization itself, rather than with reference to a particular host country environment, MNEs can be expected to manage these liabilities better over time as their stock of internationalization knowledge grows; i.e., as they gain experience through the ongoing internationalization process (Eriksson et al., 1997; Henisz & Delios, 2002). This calls for “knowing what knowledge is required in different situations and different settings connected with internationalization, and where to seek this knowledge” (Eriksson et al., 1997, p. 345).
THE CASE FOR LIABILITIES OF ORIGIN

Consider the following anecdote:

Sarik Tara, chairman of Enka Holding, Turkey’s biggest construction company, has learnt to search for contracts in difficult places. “I am stamped ‘Made in Turkey’, not ‘Made in Germany’,” says Mr. Tara. “I have to try harder. No one is going to ask me to build anything in the Champs Elysees.”

(Cuervo-Cazurra & Genc, 2008, p. 957)

What disadvantage does this suggest? This does not seem to be an instance of LOF because Mr. Tara suggests that other foreign firms such as a German construction firm may be more welcome in Paris’ most prominent stretch. Furthermore, experiential learning in the host country and adaptation to the local institutional environment would probably do little to attenuate the adverse effect of “stamping” that he refers to. Nor, clearly, does this relate to the complexity and coordination costs we referred to earlier as the liabilities of multinationality. Instead, Mr. Tara’s statement draws our attention to a very different disadvantage – one that may go hand in hand with LOF for EE MNEs in developed economy markets – the liabilities of origin, which emerge as a direct consequence of the national origins of the firm. These disadvantages, which we label the liabilities of origin – a term used earlier by Bartlett and Ghoshal (2000) – can impact the firm’s performance through a variety of processes such as organizational imprinting, organizational identity, image, capability development, and resource scarcity.

Morgan (2001, p. 1) proposes, “multinational firms are social constructions… they are built out of specific national institutional contexts that shape how they internationalize.” The implications of accepting this view are far-reaching. This not only implies that the MNE identity is shaped by home country imprinting, but also that the imprinting retains its potency even as the firm internationalizes (cf. Bartlett & Ghoshal, 1989; Brahm, 1994; Kogut, 1993; Kogut & Zander, 1993). MNEs, then, are not anchor-less business enterprises floating in the global economic sphere, making operationally optimal decisions of investment, and complementing them with perfectly synchronized cognitive capabilities and seamlessly adaptive resources. Their strongest anchors lie, arguably, in their national origins that mark them out not only in terms of their administrative heritage and idiosyncratic asset bundles, but also in terms of how they identify themselves and how their host country stakeholders regard them.
Firms – as one kind of institution in a national society – imbibe characteristics of the varying institutional contexts of their origin and “these variations can be quite telling when firms based in different countries collide in shared international markets” (Brahm, 1994, p. 43). When foreign firms from different countries enter a given host country, the institutional rules of the game (North, 1990) may enable some foreign firms (apart from the local firms) and disable other foreign firms. In the LOF stream, scholars have paid significant attention to understanding the disadvantages that subsidiaries of foreign firms suffer in a host country by virtue of their outsider status. However, LOF as a concept cannot account for the disadvantage borne by MNEs in host countries as a consequence of their national origins. Put simply, while LOF explains disadvantages borne in host countries by MNEs as a consequence of where they are not from (i.e., not from the host country), the term “liabilities of origin” seeks to capture those disadvantages of MNEs that emerge as a consequence of where they are from. This is not merely a semantic distinction; it connotes significant conceptual differences that we shall discuss in a subsequent section. First, however, in this section, we shall examine the specific disadvantages contained within the liabilities of origin (henceforth, LOR).

We propose that while the adverse effects of LOR are experienced by the MNE in the host country (or just prior to entry into the host country), its sources lie in three distinctive contexts of the MNE’s ongoing activity. These are: the home country context, the host country context, and the organizational context. We discuss these below with reference to EE MNEs entering developed country markets.

The Home Country Context of LOR

In the early days of IM as a distinctive field of study, Hymer (1960, p. 71) had remarked upon the importance of the peculiarities of the home country context for the competitiveness of local firms thus: “Why do firms of different countries have unequal ability? In part, it is due to the fact that there is an unequal distribution of skills among people ... In part it is also due to the chance discovery of a gold mine, a valuable formula, or Scotch Whiskey.” Over the years, the role played by the home country context in shaping the competitive advantage of the indigenous MNE has become well established in the IM literature (Dunning, 1979; Makino, Isobe, & Chan, 2004; McGahan & Victer, 2010; Nachum, 2003; Porter, 1990). However, less attention is paid generally to how the home country context can
systematically create disadvantages for indigenous MNEs (cf. Witt & Lewin, 2007). Miller and Richards’ (2002) study in the European Common Market found that the importance of the home country environment of the MNE rises as the competitive intensity in the host country market increases. For EE MNEs, this would suggest a serious disadvantage vis-à-vis developed country firms on the latter’s home base since emerging economies are hampered by underdeveloped economic and institutional infrastructure (Hitt, Dacin, Levitas, Arregle, & Borza, 2000). We propose that the disadvantages pertaining to the home country context of LOR are those that can be traced to underdeveloped home country institutional intermediaries rather than to institutional distance per se (cf. Phillips, Tracey, & Karra, 2009). In this section, we focus on two specific dimensions of such a disadvantage for EE MNEs: poor access to well-developed financial markets and poor access to a flexible, skilled talent base.

The financial system in emerging economies remains underdeveloped and seriously limits the ability of EE MNEs to access patient capital for investing in international growth (Aulakh, Kotabe, & Teegen, 2000; Hitt et al., 2000). Compounding the problem is the high volatility and high risk associated with emerging economies that makes capital more expensive in these countries (Hitt et al., 2000). Concurrently, perceptions of poor corporate governance practices in emerging economies (Bell, Moore, & Al-Shammari, 2008) and the higher potential for principal–principal conflicts in emerging economy business groups (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008) increase the cost of capital in international capital markets for these firms. International new ventures or born global firms are worse off because venture capital institutions in Asia are less pervasive than in the Anglo-American economic system, driven more by personal networks, and can provide little value addition in terms of enabling international growth strategy (Ahlstrom & Bruton, 2006).

Since most emerging economies have only recently opened up to external economic influence, the skill development and control systems (cf. Whitley, 1999) in these countries continue to be mostly inward-looking. Emerging economy firms making inroads into developed economy markets need to be well equipped with managers having the skill set and experience to work in mature market economies and manage cross-national operations. The low level of historical engagement of emerging economy firms with international operations implies that there is an extremely scarce pool of managerial talent in emerging economies that meets such criteria (Aulakh et al., 2000; Peng & Heath, 1996; Uhlenbruck, Meyer, & Hitt, 2003). The absence of a skill development system that can provide global managerial talent imposes
high costs on emerging economy firms entering developed markets and slows the process of their internationalization. It also makes difficult the transfer of firm-specific advantages to subsidiaries since such transfers rely heavily on the use of expatriates from the home country (cf. Matsuo, 2000). Furthermore, labor markets in emerging economies lack flexibility because they are often regulated so as to overprotect entrenched labor interests (Chacar & Vissa, 2005; Patibandla, 2006). Such institutional rigidities in the country’s control system reduce the EE MNE’s ability to recast its talent resource base in order to meet opportunities in developed country markets.

The Host Country Context of LOR

The essence of the host country context of LOR lies in the disadvantages pertaining to adverse (host country) institutional attribution. By this, we refer to the discrimination against firms from a particular country (or region) because of their (real or perceived) conflict with the regulative, normative, or cultural-cognitive elements of the host country institutional environment. For example, Kostova and Zaheer (1999) have referred to the possibility of negative legitimacy spillovers when an MNE is adversely judged by host country constituents based upon their negative perceptions of the class of organizations (e.g., Brazilian firms or Latin American firms) to which they assign the said MNE. Indeed, adverse institutional attributions by host country constituents need not be restricted to certain industries. As Ghemawat (2007, p. 58) notes, “The country of origin matters – even for capital, which is often considered stateless.”

As discussed earlier, discrimination against foreign firms by host country constituents has been identified as a potential source of LOF. Discrimination by host country constituents would also be regarded as a primary component of the host country context of LOR, but with a significant difference. While LOF attends to discrimination against firms because of where they are not from (i.e., not local), the proposed concept of LOR would relate to discrimination by host country consumers and governments because of where they are from (i.e., their specific country of origin). This distinction is significant and can be analogically understood in terms of the distinction drawn in the international marketing literature between the concepts of consumer ethnocentrism and consumer animosity.

Consumer ethnocentrism refers to the tendency of a given set of consumers to purchase local goods in preference to foreign goods while consumer animosity reflects the intention of consumers in a given country to
abstain from purchasing products of a specific foreign country (Klein, Ettenson, & Morris, 1998). Klein (2002, p. 348) remarks that, “favorable opinions toward buying foreign goods in general could mask potent attitudes against buying from a specific foreign country.” Clearly, consumer animosity may play a role in creating LOR for a firm from the country for which animosity is borne. For example, L’Oreal sales in Australia and New Zealand dipped in the aftermath of nuclear testing by France in the South Pacific (Klein, 2002). We would expect, however, that a far more significant role in the LOR of EE MNEs in developed country markets would be played by negative perceptions, stereotypes, or beliefs regarding product or service quality associated with their country of origin.

In the case of EE MNEs entering developed economy markets, negative country images (e.g., about India) and negative product-country images (e.g., about automobiles from India) constitute a prominent source of competitive disadvantage and have been long acknowledged in the international marketing literature (Bilkey & Nes, 1982; Johansson, Ronkainen, & Czinkota, 1994; Verlegh & Steenkamp, 1999). For example, Johansson et al. (1994) found that tractors from Belarus (the largest tractor manufacturer in the world) found it very difficult to penetrate the US market due to the unwillingness of US farmers to buy an “unfamiliar” product “made in a developing economy.” The authors reported that, in this case, negative country-of-origin effects and peer pressure prevented farmers from buying a product that they privately found acceptable. These consumer biases prevail among purchasers of both consumer and industrial goods (Chao, 2001; Verlegh & Steenkamp, 1999).

Negative country images and product-country images have been found to be particularly debilitating when the reputational capital of the firm or its products has not yet been built up (Cordell, 1992; Johansson et al., 1994; Maheswaran, 1994). But the building of brands and reputations is itself made more arduous by the absence of positive country images. Moreover, negative product-country images are resilient to erosion and may call for a long-term virtuous cycle of coevolution with the country image and the brand image (Verlegh & Steenkamp, 1999), as exemplified by the evolution of the “Made in Japan” label from the 1960s to the 1980s (Nebenzahl, Jaffe, & Lampert, 1997).

MNEs may also suffer from LOR on account of the host country government’s policies and misgivings about firms from a particular country (cf. Cuervo-Cazurra et al., 2007). While host governments may discriminate against foreign firms in general to protect domestic industry, discrimination against firms from a particular country would, more often, be driven by
either ideological or strategic concerns. For example, in 2006, the
governments of France and Luxembourg initially opposed the takeover of
the steel firm Arcelor by Mittal Steel (which had an Indian management),
while being more amenable to a Russian takeover (Goldstein, 2008).
In earlier decades, US MNEs were treated with suspicion in much of the
developing world and even in Europe because of fears that they may serve as
channels for the exercise of power by the US government (Vernon, 1971,
1977). In the coming years, as emerging economies gain in global politico-
economic power, EE MNEs may face increasing hostility from governments
in the developed world for similar reasons. “If that were to happen,”
Aharoni and Ramamurti (2009, p. 193) observe, “the expansion of MNEs
from emerging markets into developed countries may get slowed down.”

The Organizational Context of LOR

The most insidious of the liabilities of origin are those that emanate
from the organizational context of the firm. These liabilities reside in the
structures, processes, and routines of the organization and emerge as a
consequence of “imprinting, organizational learning, or firm experience
with certain kinds of institutions in the home country” (McGahan & Vieter,
2010, p. 161). Organizational structures, processes, and routines become
disadvantages for the MNE when they lead to cognitive maladjustment in the
host country. We consider these disadvantages separately from those
considered under the home country context because, while the disadvan-
tages considered under the home country context remain environmental
factors, the ones we consider here are those that get internalized into the
organization.

The salience of LOR in the organizational context for EE MNEs may
well make their LOF in host markets more arduous and longer lasting.
As discussed before, overcoming LOF in foreign markets requires
experiential learning. The ability of EE MNEs to adapt to developed
economy markets and, thereby, lower their LOF is often constrained due
to the underdeveloped and underexposed learning processes within the
organization. The organizational learning processes in EE MNEs may
remain underdeveloped and underexposed because of the relative inexperi-
ence of EE MNEs in dealing with rapidly changing international business
environments, and also because most EE MNEs would have only recently
commenced internationalization after decades of being purely domestic
firms (cf. Eriksson et al., 1997). Uhlenbruck et al. (2003) argue that the
ability of emerging market firms to adapt to institutional transitions is limited by ineffective resource development and deployment, and poor learning routines.

Moreover, firms in an emerging market, isolated by cultural, administrative, geographic, and economic distance (Ghemawat, 2001) from developed economies, develop a contextual set of cognitive frames that adversely affect their abilities to compete in developed economies. Differences in the home institutional environments shape the constitution of managers' strategic orientation and their implicit values and beliefs differently (Hitt, Dacin, Tyler, & Park, 1997; Kriauciunas & Kale, 2006; McGahan & Victer, 2010; Noorderhaven & Harzing, 2003). Managers in emerging economies look very differently at opportunities, risks, and resources (Hitt et al., 2000) and may carry over these cognitive frames to their engagement with developed economy markets, leading to two very different kinds of errors of judgment. On one hand, managers of EE-MNEs may find themselves skeptical of the global potential of their product or service and may be rendered immobile by self-doubt (Bartlett & Ghoshal, 2000; Thomas et al., 2007). One of the biggest hurdles that champions of internationalization programs in EE-MNEs face, while seeking to orient the organization to multinational operations, is the lack of credibility for their agenda with their own colleagues. In an emerging economy, with few success stories of peer firms who have successfully competed with developed economy firms in the latter’s home market, it calls for a certain amount of credulity to believe in an ambitious internationalization program directed at a developed economy. On the other hand, limited exposure to competitors from developed economies may fuel their ambition to such a degree that they become blind to the potential dangers of premature entry into developed economies and leap into an ill-conceived internationalization program (Bartlett & Ghoshal, 2000; Thomas et al., 2007).

Even as firms become highly internationalized, their country of origin and their administrative heritage remains an influential determinant of their organizational control practices (Bartlett & Ghoshal, 1989; Harzing & Sorge, 2003). The “institutional voids” in emerging economies have been viewed as shaping particular aspects of business organization in these economies, leading to the preponderance of family-owned business groups (Khanna & Palepu, 2000; Khanna & Yafeh, 2007). A recent study has suggested that the family business organizational form may be suboptimal as the firm seeks to internationalize in order to access markets and resources (Bhaumik, Driffield, & Pal, 2010). Thus, inertial organizational structures may prove to be another source of LOR for EE MNEs.
In this section, we have discussed the ambit of the concept of LOR with reference to three dimensions: home country context, host country context, and organizational context. We argued that the essence of the disadvantage in these three dimensions of LOR lies, respectively, in underdeveloped (home country) institutional intermediaries, adverse (host country) institutional attribution, and cognitive (organizational) maladjustment (see Fig. 1). From the preceding discussion, we can see that two kinds of disadvantages cut across the three dimensions – capability-based disadvantages and legitimacy-based disadvantages. The former includes lack of access to comprehensive and efficient capital markets and to global managerial talent, and inappropriate organizational learning routines. The latter includes discrimination by host country customers and governments, and lack of credibility within the organization for the internationalization program.

**LIABILITY OF FOREIGNNESS VERSUS LIABILITIES OF ORIGIN: CONCEPTUAL DIFFERENCES**

We now examine conceptual differences between LOF and LOR. We forego a detailed examination of the differences between LOR and the liabilities of multinationality because there are no apparent overlaps; LOR, like LOF, is always borne with respect to a particular host country, whereas the liabilities
Table 1. Proposed Differences between Liability of Foreignness and Liabilities of Origin.

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<tr>
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<th>Liability of Foreignness</th>
<th>Liabilities of Origin</th>
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<tbody>
<tr>
<td>Connotation</td>
<td>Disadvantages borne by MNEs in host countries as a consequence of where they are not from (i.e., not local)</td>
<td>Disadvantages borne by MNEs in host countries as a consequence of where they are from (i.e., their specific nationality)</td>
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<tr>
<td>Elements of specification</td>
<td>Dyad of a particular subsidiary in a particular host country</td>
<td>Triad of a particular MNE in a particular host country and originating in a particular home country</td>
</tr>
<tr>
<td>Home country influences</td>
<td>Explicitly excluded</td>
<td>Explicitly included</td>
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<tr>
<td>Unit of analysis</td>
<td>Subsidiary organization</td>
<td>MNE organization</td>
</tr>
<tr>
<td>Acquisition of cognitive legitimacy in host country</td>
<td>Experiential learning leading to two-way comprehensibility between the MNE subsidiary and host country constituents</td>
<td>Challenging taken-for-granted stereotypes about firm’s country of origin and rebuilding comprehensibility</td>
</tr>
<tr>
<td>Role of (home country) state agencies</td>
<td>Insignificant</td>
<td>Significant</td>
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of multinationality are agnostic with regard to the host country. On the other hand, there are significant parallels between the extant concept of LOF and the proposed concept of LOR. Both refer to (relative) institutional costs CDBA borne in the course of doing business in the host country. Both have consequences for the capabilities as well as the legitimacy of the disadvantaged firms. Yet, there are key conceptual differences too, as we discuss here and summarize in Table 1.

1. The terms “foreignness” and “origin” themselves signal a key difference between LOF and LOR. While LOF refers to the disadvantages borne in the host country by firms as a consequence of where they are not from, LOR connotes the disadvantages borne in the host country by firms as a consequence of where they are from. LOF exists for firms because they are not local; their specific nationality is less material. LOR, on the other hand, flows from the specific nationality of a firm.
2. LOF is a dyadic concept. Zaheer (2002, p. 353) states that LOF is “focused on the dyad of a subsidiary in a particular host country.” LOR, on the other hand, can be specified only in terms of a triad: the triad of an MNE (say, Tata Motors) in a particular host country (the United Kingdom) and originating in a particular home country (India). Thus, when Zaheer (2002, p. 352) refers to how the 9/11 terror attacks “may have increased the LOF (by affecting access and legitimacy) of only certain firms from specific home countries (e.g. Somalia, the Middle East), in specific host countries (e.g. the United States),” we would suggest that she is actually referring to the LOR for these firms, and not LOF.

3. LOF as a concept is intentionally devoid of any home country influences. According to Mezias (2002a, 2002b), examining LOF effects necessitates the identification and removal of home country influences. Thus, “identifying liabilities of foreignness requires including foreign firms from several different countries to rule out spurious findings stemming from country-of-origin fixed effects, such as administrative heritage” (Mezias, 2002a, p. 271). The proposed concept of LOR, however, takes home country influences into consideration both explicitly (in terms of the home country context) and implicitly (in terms of the organizational context).

4. The appropriate unit of analysis for LOF has been shown to be the subsidiary. For LOR, however, the appropriate unit of analysis is the corporation in its entirety, and not the subsidiary. By definition, LOF can only be experienced by the subsidiary and different subsidiaries of an MNE may experience different forms and levels of LOF (Eden & Miller, 2001; Zaheer, 2002; Zaheer & Mosakowski, 1997). Zaheer (2002, p. 353) observes, “foreignness is an inherently dyadic concept and a multinational enterprise is unlikely to be foreign in its headquarters country.” Indeed, the attenuation of LOF may be delayed for the subsidiary as a direct consequence of the headquarter pursuing its own objectives. Mezias (2002a) refers to the use of subsidiaries as training ground for managers from headquarters as a reason for prolonged LOF. He observes further, “the focal point of liability of foreignness research is the foreign subsidiary, but MNCs do not always maximize subsidiary performance because subsidiary-level optimizing may compromise overall MNC performance” (Mezias, 2002a, p. 278). LOR, on the other hand, needs to be viewed at the level of the corporation or the multinational network. Empirically, we would expect the effect of origin on the subsidiary and on the headquarter to be indistinguishable. Conceptually, since the source of the disadvantage lies in the “origin” of the firm,
the headquarters, the subsidiary, and the sister subsidiaries would all face the consequences of the disadvantage.

5. The implications of LOF and LOR for the cognitive legitimacy of the firm – as bestowed by host country constituents – are also very different. Cognitive legitimacy may be understood as “legitimacy grounded in cognitive interpretations of appropriateness and interpretability” (Suchman, 1995, p. 572). Two variants, in particular, of cognitive legitimacy have been highlighted: comprehensibility and taken-for-grantedness (Suchman, 1995). Comprehensibility “stems mainly from the availability of cultural models that furnish plausible explanations for the organization and its endeavors,” thereby making them “predictable, meaningful, and inviting” (Suchman, 1995, p. 582). Taken-for-grantedness, however, emerges from beliefs about the organization and its activities becoming institutionalized themselves such that it is scarcely feasible, within the bounds of the institutional context, to develop an alternate conceptualization about the organization (Suchman, 1995). As LOF has been theorized as a problem of two-way uncertainty or, to use Eden and Miller’s (2001) phrase, as the problem of the “stranger in a stranger land,” overcoming LOF would essentially involve enhancing comprehensibility about the organization among host country constituents through a gradual, iterative process of learning about the distinctive aspect of the host institutional environment and adapting to the environment. On the other hand, the elements of LOR that correspond to the beliefs held by host country audiences are hardly about the lack of comprehensibility. The challenge for firms facing LOR in host country markets is not that their activities may not be comprehended at all, but that they may be misunderstood comprehensively. This is so because adverse stereotypes about firms from a particular country may become taken-for-granted. The legitimacy task for EE MNEs, then, is not simply to be comprehensible to host country constituents but to gradually challenge the extant taken-for-granted understanding and then rebuild comprehensibility.

6. Overcoming LOF essentially calls for firm-level initiatives that enable adaptation to the host institutional environment. However, overcoming LOR would generally entail not only firm-level initiatives, but also the involvement of State agencies. State agencies in the home country of the firm may need to get involved because the legitimacy deficit, or the capability deficit, underlying a particular case of LOR would often reflect substantial externalities, e.g., negative country images, or inefficient domestic financial market institutions.
MANAGING LIABILITIES OF ORIGIN: POTENTIAL PATHWAYS

As we have argued above, LOR includes capability-based disadvantages and legitimacy-based disadvantages, and the sources of these disadvantages lie in three distinct, but interrelated contexts of the MNE’s ongoing activity – the home country context, the host country context, and the organizational context. To explain the nature of these disadvantages, we drew upon the case of EE MNEs seeking to enter developed economy markets. As there is already an ongoing vigorous discussion on how EE MNEs can overcome their capability-based disadvantages (Buckley et al., 2007; Chittoor et al., 2009; Luo & Tung, 2007), this section focuses on their legitimacy-based disadvantages. We identify two theoretical approaches – institutional entrepreneurship and organizational identity – that may prove useful in understanding how EE MNEs overcome LOR in terms of the legitimacy-based disadvantages.

Institutional Entrepreneurship

Currently, studies of legitimacy in the MNE context lean excessively, in our view, on the neo-institutional perspective on legitimation. The underlying argument in these studies has been that MNEs acquire legitimacy in host countries by conforming to the institutional demands of the host country environment and becoming similar (i.e., by the process of isomorphism) to established organizations in the relevant organizational field (Chan, Makino, & Isobe, 2006; Li, Yang, & Yue, 2007; Lu, 2002). From the point of view of EE MNEs, however, the critical issue – which has been neglected so far in the IM literature – is that it may be too costly or even unfeasible for these organizations to acquire legitimacy through conformity to existing institutional demands in the host country. EE MNEs may not have the resources to conform to the host country institutional demands, or it may be simply unfeasible for their business models to adapt to the demands made by actors in the host country institutional environment. Moreover, for some EE MNEs, adverse country images in the host country may deprive them of legitimacy even when they conform to the local institutional demands (cf. Francis, 1991; Eden & Miller, 2004).

In organization theory, the literature on institutional entrepreneurship emerged as a corrective to the overly deterministic character of the earlier neo-institutionalist theories of organization (Garud, Hardy, & Maguire, 2007;
Hirsch & Lounsbury, 1997). Battilana, Leca, and Boxenbaum (2009, p. 66) observe, “whereas early institutional studies considered mainly the constraints under which actors operate and other effects of institutions on actors, work on institutional entrepreneurship aimed to build a theory of action.” Earlier, DiMaggio (1988, p. 14) had introduced the central idea of institutional entrepreneurship thus: “new institutions arise when organized actors with sufficient resources (institutional entrepreneurs) see in them an opportunity to realize interests that they value highly.” Central to the scholarship on institutional entrepreneurship is the role of intentionality, interest, and agency in altering institutional arrangements (Garud et al., 2007).

Scholars have begun appreciating the theoretical benefits of using an institutional entrepreneurial perspective in theories of the MNE. Kostova, Roth, and Dacin (2008) observe that MNEs exist at the intersections of multiple, contradictory institutional environments and that individual environments rarely control all the valuable resources required by MNEs. Consequently, they argue, isomorphism in the host country’s institutional environment may not always be necessary or even feasible for the MNE to secure legitimacy in that environment. In a parallel argument, Phillips et al. (2009, p. 344) note, “While MNEs are clearly constrained by institutional structures, the scholarship on institutional entrepreneurship highlights the skills and capabilities that organizational actors can use to engender institutional change.”

Institutional entrepreneurship provides us with a useful perspective to understand how EE MNEs, facing substantial LOR in developed country markets, can manage their legitimacy-based disadvantages. It has been suggested, for example, that scarcity of resources (required under the extant institutional regime) can provoke actors to don the role of institutional entrepreneurs and introduce discrepancies into the institutional regime that lead to institutional change and, thereby, address their interests (Durand & McGuire, 2005). Bricolage, or the art of making do with available resources to address new problems or opportunities, can be seen as a crucial aspect of such institutional entrepreneurship (Baker & Nelson, 2005; Phillips & Tracey, 2007). Others have argued that the presence of multiple, highly contradictory institutional orders enhances the capacity to envision alternate possibilities for institutional arrangements (Seo & Creed, 2002). Furthermore, a constant refrain in this research stream has been that peripheral and low-status organizations can often be found to have initiated divergent institutional change (Battilana et al., 2009). As low-status, peripheral multinational entities with severe resource scarcities and straddling contradictory institutional regimes, EE MNEs may need to
engage in institutional entrepreneurship in order to construct “alternative legitimating mechanisms” (Kostova et al., 2008, p. 1001).

These alternate legitimating mechanisms may be developed in negotiation with individual (salient) institutional actors through a variety of strategic responses that go beyond mere acquiescence (Oliver, 1991). In order to establish their legitimacy in host country environments through alternate mechanisms, EE MNEs would require mobilization of resources so as to make these resources meaningful in the host country institutional environment, the development of powerful rationales for the change proposed, and the creation of purposeful relations with the salient institutional actors (cf. Hardy & Maguire, 2008). To the extent that these activities require collaboration among firms facing a similar legitimacy deficit, an institutional entrepreneurship lens also highlights the importance of collective action in acquiring legitimacy when legitimacy acquisition under the extant institutional arrangements is too costly or difficult. Consider an industry association. As a collective agent, it can lobby the State for policy changes that enhance the development of home country institutional intermediaries (home country context), chip away at negative institutional attribution in the host country by undertaking image-building measures and building relationships with key institutional actors in the host country (host country context), and facilitate the development and diffusion of best practices among its members (organizational context).

Organizational Identity

Although institutional entrepreneurship can help engender new institutional rules that enable a collective of EE MNEs to acquire legitimacy, the skilful management of organizational identity can enable individual EE MNEs to build on these collective legitimacy gains by crafting highly individualized legitimation narratives. Organizational identity, or the conceptions of organizational insiders about “Who we are as an organization” (Albert & Whetten, 1985; Dutton & Dukerich, 1991), and the corresponding organizational image (i.e., how the relevant outside stakeholders perceive the organization) (Dutton, Dukerich, & Harquail, 1994) can play a crucial role in enabling (or hindering) the acquisition of legitimacy in host country institutional environments. An organization’s identity will be intertwined with its acquisition of legitimacy in its institutional environment because identity corresponds to certain codes or rules – grounded in default expectations from the organization – to which an organization is expected to
conform (Pólos, Hannan, & Carroll, 2002). Failure to conform to any of the appropriate sets of codes or rules can lead to loss of legitimacy for the organization (Zuckerman, 1999). As Tripsas (2009) explains, “organizational identity serves a coordinating role, providing a focal point for both insiders and outsiders about what constitutes legitimate action on the part of an organization. As such, identity guides the development of capabilities, the acquisition of knowledge, the evolution of routines, and the framing of issues.” Thus, the beliefs that are held by insiders and outsiders about the organization’s identity set bounds on the organization’s legitimate activities. Indeed, the organization’s identity shapes the strategic choices of the organization and underlies successful strategic change initiatives (Barney, 1998; Fiol, 2001; Nag, Corley, & Gioia, 2007).

The EE MNE’s identity (and image) can substantially affect their LOR in developed country markets. For example, in the host country context, the EE MNE’s nationality (and the associated beliefs and connotations) can shape the organization’s image and can define the bounds of what the organization can legitimately do (and not do). In the organizational context, members of the organization may be handicapped by self-doubt and skepticism because their organizational identity fails to accommodate the appropriateness of the act of entering developed country markets and challenging established global industry leaders in their home markets.

How can reframing organizational identity help EE MNEs overcome LOR? Broadly, organizational leaders seeking to manage stakeholder expectations through identity management can undertake either identity change strategies or identity preservation strategies. As the organization’s identity bears a close association with the organization’s image held by key external stakeholders (Gioia & Thomas, 1996), overcoming LOR in the host country context may require the EE MNE to undertake a gradual process of identity change in order to induce an attractive image among host country constituents. The process of identity change would require the EE MNE to develop alternative narratives linking together in a consistent manner the past, present, and the future of the organization (Chreim, 2005; Gioia, Schultz, & Corley, 2000). Alternate narratives of the organization’s identity can reframe the past by reinterpreting the meaning of specific identity labels in order to establish a linkage with the desired future image (Gioia et al., 2000). It must be noted, however, that the images held by host country constituents about the EE MNE may have a certain taken-for-granted quality about them when these images are shaped by broader, enduring impressions about the country of origin. Such narratives would, then, typically involve both sensebreaking (challenging the taken-for-granted
identity or image) and sensegiving (presenting an alternate, reasonable identity narrative) processes in iterative cycles (Gioia & Chittipeddi, 1991; Pratt, 2000). Alternate narratives of the organization’s identity can also help overcome LOR in the organizational context by presenting a desired future identity around which organizational leaders can align the collective understanding of organizational members about the organization (Ravasi & Schultz, 2006) and rework organizational practices and routines (cf. Nag et al., 2007).

EE MNEs seeking to overcome their LOR can also do so by following identity preserving strategies such as maintenance of multiple identities (Pratt & Foreman, 2000), or selective categorization to leverage positive identities (Elsbach & Kramer, 1996; Swaminathan, 2001). EE MNEs could select categories of affiliation that downplay (perceived) negative aspects of their identities and emphasize the positive aspects of their identities (or images). Multiple identities can help the EE MNE retain flexibility of action while being consistent with their “central, enduring and distinctive” character (Albert & Whetten, 1985; Padgett & Ansell, 1993; Pratt & Foreman, 2000). Indeed, multiple identities can prove to be of great utility to EE MNEs seeking to balance entrenched home country influences with very different host country institutional demands.

CONCLUSION

We have presented, in this paper, a conceptualization of the liabilities of origin – the capability-based and legitimacy-based disadvantages borne with respect to a specific host country by MNEs as a consequence of their national origins. We proposed that these disadvantages emerge from three contexts of the MNE’s ongoing activity – the home country context, the host country context, and the organizational context. We presented LOR as a complementary concept to LOF and the liabilities of multinationality for the purpose of comprehensively examining the nature of disadvantages of MNEs. We also suggested that the literatures on institutional entrepreneurship and organizational identity may prove to be useful in understanding how MNEs can overcome LOR. Throughout this paper, we developed our arguments by focusing on the case of EE MNEs entering developed country markets. We hope that this conceptualization of LOR will contribute to the IM literature in two ways. One, by suggesting that we examine not only the unique advantages of EE MNEs in international markets, but also their distinctive disadvantages in order to gain a comprehensive understanding of
their internationalization journey. Two, by drawing attention to the importance of the national origins of MNEs in shaping their disadvantages abroad.

Clearly, the concept of LOR needs further development in terms of refinement, as well as extension. We have not, for example, distinguished between market-seeking and resource-seeking internationalization into developed countries by EE MNEs. Nor have we examined how the nature of the industry, e.g., consumer goods versus industrial goods, may impact the incidence of LOR. More work needs to be done in order to understand how LOR varies under these conditions. Nevertheless, anecdotal evidence suggests that the LOR faced by EE MNEs in developed economy markets are not suppressed even in the case of knowledge-intensive industries such as the software services industry, where one might expect legitimacy challenges corresponding to low comprehensibility and cultural-cognitive biases to be largely irrelevant. As an illustration, consider this excerpt regarding one of India’s leading software services companies from a Forbes (1999) article, “Despite a roster of big-name North American clients, Infosys was battling the crass Western perception that a smart, honest, reputable company could never come out of a country where cows still run in the street.”

Although the discussion in the paper has been developed primarily around the case of EE MNEs, it is evident that MNEs from developed countries too can suffer from LOR. Arla Foods, a Danish dairy producer that had been in the Middle East for over 40 years saw its sales dropping to negligible levels in 2006 as customers undertook a boycott of Danish goods following the publication of controversial cartoons in a Danish newspaper (Telegraph, 2006). Further back in history, we find reference to longer-lasting LOR for early American multinationals in Wilkins’ (1970, pp. 35–112) history of American investment abroad. She refers to several disadvantages suffered by early American multinationals in Europe – lack of easy access to capital, low credibility with European customers, and projection of negative country-images to the individual firm (as when several states in New England defaulted on their loans from European bankers). Nevertheless, EE MNEs would probably provide the most substantive empirical base in contemporary times for an examination of the nature, consequences, and attenuation of LOR. Ramamurti (2008) observes that academic research in the field of IM took off when MNEs from developed countries, especially the United States, were already past the early stages of their internationalization. Consequently, research focused on
the contemporary problems of American MNEs (deploying advantage) rather than try to understand how MNEs arose in the first place (overcoming disadvantage). In this sense, our conceptualization of LOR, while drawing upon the experience of EE MNEs with regard to overcoming disadvantage, can be juxtaposed against Porter’s Diamond model (1990) that drew upon the experience of developed country MNEs to examine the conditions for the international deployment of advantage. Ramamurti asserts, “the issues that arise in internationalization are quite different in the early stages of that process, when firms are building global presence, than in the later stages, when the firm has already built a sprawling network of overseas subsidiaries … studying [EE MNEs] provides an opportunity to revisit the issues that arise as firms internationalize – and that too in a contemporary twenty-first century context” (Ramamurti, 2008, pp. 14–15). As we collectively consider the “Past, Present and Future of International Business and Management” in this volume, the contemporary rise of EE MNEs provides a valuable opportunity to examine, in detail, the bases of competitive disadvantage in international markets while building upon the past achievements of the field regarding the deployment of advantage internationally.

Surprisingly, the emerging economy setting has been scarcely used for the development of new theory. Most of the IM research centered on emerging economies has been motivated either by an objective of theory verification or of theory extension. Indeed, the primary opportunity for IM researchers with regard to the growing prominence of emerging economies as an arena of international business is the development of alternate theories through rich, grounded empirical insights. This would call for, we believe, at least a temporary privileging of case studies over variance studies among IM researchers engaging with the emerging economies (Pant, Gunta, & Ramachandran, 2008).

Our discussion on the LOR of EE MNEs also points to the need for IM researchers to engage with the rich literatures on institutional entrepreneurship and organizational identity. We have sought, in this paper, to provide an indicative overview of how these theoretical lenses can help IM researchers understand how firms can overcome LOR. These literatures can help us understand how firms – faced with debilitating “costs of access and acceptance” (Zaheer, 2002, p. 352) as a consequence of their national origins – can overcome deep-seated influences of organizational imprinting and rework the institutional rules that constrain them in order to compete effectively in international markets.
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REFERENCES


An Emerging Economy Perspective on the Costs of Doing Business Abroad


COUNTRY LEVEL CORRUPTION AS A LIABILITY OF FOREIGNNESS: EFFECTS ON STAFFING, INCENTIVES, AND ACTIVITIES

John M. Mezias and Stephen J. Mezias

ABSTRACT

Past research examining country-level corruption found that corruption reduces foreign direct investment. However, this research lacks implications for multinational corporations considering operating in high corruption countries. Recent international research has examined subsidiary challenges beyond initial investment decisions, but has not addressed operational challenges posed by corruption. Research investigating country-level corruption as a liability of foreignness (LOF) is needed because this theoretical perspective specifically examines mechanisms for managing and controlling subsidiaries. This paper utilizes the LOF perspective, integrating learning, international human resource management, and agency theories, to understand how corruption affects subsidiary adaptation strategies.
INTRODUCTION

Corruption, defined by Gould and Kolb (1964, p. 142) as the use of power for “... profit, preferment, or prestige, or for the benefit of a group or class, in a way that constitutes a breach of law or of standards of high moral conduct,” has been a core problem of human administration since the dawn of recorded history. Modern social sciences, particularly with respect to global trade and economic development, have developed a systematic and comparative approach to the analysis of corruption (Scott, 1969). Early analyses using specific events to quantify broad concepts like political risk (e.g., Kobrin, 1976) led to sophisticated measurement of specific concepts related to corruption, yielding research confirming important relationships between economic activity and country-level corruption (hereafter referred to as corruption). Although early anecdotal evidence, analytical models, and studies suggested that corruption might not adversely affect economic growth (e.g., Huntington, 1968; Leff, 1964; Wheeler & Mody, 1992; Hines, 1995); however, subsequent work using more systematic measures of corruption yielded much evidence that it reduces both economic growth and foreign direct investment (FDI).

Using corruption indices based on expert opinion, Mauro (1995) found a negative association between corruption and investment that was statistically and economically significant. Husted (1999), using perceptual measures of corruption, found that higher economic growth was associated with lower corruption. Focusing on the related question of government interference with private property rights, Henisz (2000) found that states creating credible policies of noninterference with private property had higher levels of economic growth. Wei (2000), using three corruption measures and controlling for factors likely to affect FDI, found a significant, negative relationship between corruption and FDI. Wei and Shleifer (2000, p. 303), using four corruption measures and multiple control variables, concluded that corruption had “… a negative, statistically significant, and quantitatively large effect on inward FDI.” Using a perceptual measure of corruption, Habib and Zurawicki (2002) found that both the level of corruption and the difference in levels of corruption between host and home country had a negative effect on FDI. Thus the literature offers compelling evidence that corruption is associated with reduced FDI.

Despite these robust findings, it is equally clear that many firms enter countries considered high on corruption according to these measures; the recent phenomenal growth in FDI to China and India illustrates this reality. Yet, the management literature offers little guidance to multinational
corporations (MNCs) entering high corruption environments (Doh, Rodriguez, Uhlenbruck, Collins, & Eden, 2003). Uhlenbruck, Rodriguez, Doh, and Eden (2006), whose study of telecom projects in emerging economies demonstrated that entry mode varied with corruption, is a notable exception. As they showed, nonequity entry modes, which reduce managerial responsibilities for operations in high corruption locations, and joint ventures, which presumably share management responsibility, are more likely when corruption is high. Notwithstanding their evidence that wholly owned entry mode was less frequently observed where corruption was high, some firms choose this entry mode, and managing operations in high corruption locales remains a challenging issue for MNCs. Indeed, Rodriguez, Siegel, Hillman, and Eden (2006, p. 736) asserted, “... the question of how firms should manage when faced with public-sector corruption continues to be among the most important and elusive research areas.”

This paper addresses this gap in the literature by examining challenges wholly owned subsidiaries face stemming from corruption. This approach seeks to advance corruption research by extending analysis of firms’ responses beyond initial FDI decisions. Many problems MNCs have managing subsidiaries in host countries can be conceptualized as liabilities of foreignness (LOF) relative to local firms. We employ the LOF perspective to develop theory about MNC strategies to mitigate challenges stemming from corruption. With its focus on the phenomenon of disadvantage, the LOF perspective incorporates arguments from international human resource management (IHRM), institutional theory, transaction cost economics, resource dependence, organizational exchange theory, and agency theory (Luo & Mezias, 2002; Zaheer, 2002). We further the applicability of this perspective by developing propositions about MNC strategies designed to mitigate effects of corruption.

We proceed as follows. The next section discusses how antecedents and effects of corruption create a LOF that affects MNC management of subsidiaries. We then discuss theories subsumed under the umbrella framework of LOF to develop theoretical justifications for why specific MNC strategies may be best suited to mitigate effects of corruption. We assess subsidiary staffing strategies and argue why MNCs may prefer using different types of expatriate or local employees where corruption is high. We then examine why incentive strategies, specifically bonus payments and stock options, could help subsidiaries avoid problems stemming from corruption. This is followed by assessing how corruption affects the scope of subsidiary operations. We close by discussing managerial implications and avenues for future research.
CORRUPTION, LIABILITYS OF FOREIGNNESS, AND SUBSIDIARY STRATEGIES

The World Bank estimated that worldwide bribes paid annually exceed $1 trillion (Nwabuzor, 2005), and evidence is mounting that corruption is the primary economic issue facing Turkey (The Economist, 2004), Russia (The Economist, 2005), China, Indonesia, Poland, and many countries in Africa (Doh et al., 2003). Although Transparency International and other nongovernmental organizations have provided insights and measures of corruption for more than a decade, there still remains considerable ambiguity about what constitutes corruption and a lack of consensus on how best to deal with it. For example, Kaufmann (2004) noted that certain business activities are considered legal in some countries while deemed illegal in other countries. Adding to this ambiguity are arguments to reconsider ethical and legal challenges to questionable practices that serve useful economic purposes (e.g., Rose-Ackerman, 1998). This lack of consensus on what constitutes corrupt actions and whether ethics or economics should drive public policy suggests that the antecedents of corruption penetrate economic, political/legal, and sociocultural environments (Collier, 2002). Furthermore, this lack of clarity and consensus on what constitutes corruption creates information asymmetries between government officials and firm managers, increases transaction costs for all firms, and exacerbates the tacit nature of locally accepted norms and practices. Indeed, corruption confounds the rules of the game (North, 1991) making it difficult to understand political, legal, and social environments. The resulting ambiguity and uncertainty is an incubator for bribes and resource misappropriation because it prevents emergence of common approaches to mitigate these ills, which complicates efforts to successfully respond to corruption.

Although corruption can potentially arise anywhere, from a purely business based perspective, we believe it poses greater challenges for foreign subsidiaries of multinationals than for domestic firms; recognizing that corruption in a society will influence all aspects of daily life. The antecedents and effects of corruption increase information asymmetries and transaction costs (Calhoun, 2002), exacerbate the tacit nature of institutional environments, and hinder identification and implementation of practices conforming to host-country legal, social, and cultural norms. However, local firms, which typically have better information about local institutional, social, and cultural environments, have a great capability to operate effectively in the presence of specific local manifestations of corruption. The capacity of
foreign firms to do this is what is at the core of LOF (Mezias, 2002; Zaheer, 1995); and issue that is likely exacerbated as an MNC enters multiple foreign markets characterized by varying levels of corruption. Although much of the focus of the extant LOF research has been on difficulties of understanding and communication between foreigners and locals within a country, there are also likely to be implications for managers across the network of affiliated units within the MNC. The coordination and control issues arising from LOF can extend beyond the dyad of one subsidiary’s relationship with the MNC parent (Sethi & Guisinger, 2002). Confusion and delays in communication, coupled with increased complexity in identifying and implementing accepted local practices, cloud paths to local legitimacy and embeddedness. Thus, corruption constitutes a powerful LOF for foreign subsidiaries and MNCs must learn to minimize its effects to succeed in the global marketplace.

Although this need to minimize effects of corruption has become increasingly more important in recent years, prior research has not, in general, conceptualized corruption as a LOF. Calhoun (2002) is a notable exception, although she did not address subsidiary adaptation to corruption. We argue that an important step in advancing corruption research is to move beyond the existing evidence of its effects on FDI to assess how specific MNC strategies can help foreign subsidiaries minimize the effects of corruption. This approach has the potential practical benefit of improved subsidiary performance, because organizational effectiveness requires adapting subunit strategies to specific environmental characteristics (Lawrence & Lorsch, 1967). This may be especially important for MNCs operating in high corruption locales because properly aligning structures with environments minimizes employee opportunism and transaction costs (Williamson, 1991).

We interpret the existing evidence to suggest that the LOF perspective is well suited for examining how MNC strategies minimize and overcome disadvantages such as corruption. For example, Zaheer (1995) found that foreign traders adopting local practices were more profitable. Her interpretation that this results from a lack of legitimacy for foreign subsidiaries not using accepted host-country practices has clear implications for how an MNC might organize bank trading rooms in foreign locations. Infusing strategies that locally accepted practices can increase legitimacy (Dimaggio & Powell, 1983; Meyer & Rowan, 1977), improve subsidiary survival rates (Zaheer & Mosakowski, 1997), increase economic efficiency (Miller & Parkhe, 2002), increase sales revenue (Luo, Shenkar, & Nyaw, 2002), and reduce the number of labor lawsuits facing foreign subsidiaries in
the United States (Mezias, 2002). However, identifying and implementing beneficial host-country practices has proven difficult because the legal, cultural, and institutional norms that drive diffusion of accepted practices are often tacit (Baron, Dobbin, & Jennings, 1986). Because local firms often possess a better understanding of these legal, social, and cultural norms, foreign subsidiaries are at a disadvantage identifying and implementing appropriate practices. We believe that countries high in corruption present even greater difficulties of identifying locally appropriate practices; thus, a critical challenge for MNCs is to develop strategies to overcome liabilities posed by corruption. In the remainder of this study, we interpret the broad set of theoretical mechanisms that have been brought to bear on the problem of LOF to suggest some specific MNC strategies to mitigate effects of corruption.

Corruption and Subsidiary Staffing Strategies

Despite important effects of foreign subsidiary staffing on competitive advantage (Scullion & Collings, 2005; Briscoe & Schüler, 2004; Gong, 2003), research in this area remains underdeveloped (Scullion & Collings, 2005; Harvey, Speier, & Novecevic, 2001). A major limitation influencing its development has been the disproportionate attention devoted to parent-country nationals (PCNs) serving as expatriate managers at foreign subsidiaries; a bias that has persisted for decades (e.g., Daniels, 1974; Reynolds, 1997; Tarique, Schuler, & Gong, 2006). The roles of host-country nationals (HCNs) and third-country nationals (TCNs), who work for the MNC but are not citizens of either the parent country or the host country, have received relatively scant attention. In fact, of the few studies acknowledging TCNs, most simply classified them in a single category of expatriate managers along with PCNs. In an attempt to move beyond this preoccupation with PCNs, we give equal attention to HCNs and TCNs in developing theoretical arguments about staffing subsidiaries in high corruption environments. Of course PCNs, HCNs, or TCNs may all possess advantages and disadvantages with respect to achieving important subsidiary activities, and MNCs likely utilize a mix of these employees across the network of subsidiaries. However, given our specific topic, we develop propositions about why an MNC might prefer to use more PCNs, HCNs, or TCNs to manage subsidiaries in high corruption locales (Table 1).
<table>
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<td>Hard to understanding environments and local “Rule of the Game”</td>
<td>Use more PCNs</td>
<td>Control via parent-country expats for internal consistency</td>
<td>Resource dependence and agency theory</td>
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<td>No clear path to local compliance and success</td>
<td>Increased complexity; hard to balance MNC and local concerns</td>
<td>Use more HCNs</td>
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<td></td>
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<td>Use more TCNs</td>
<td>Utilize third-country expats to balance home and host country issues</td>
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All foreign subsidiaries face conflicting pressures to maintain consistency with parent practices and to adapt to local conditions (Bartlett & Ghoshal, 1989; Evans & Lorange, 1989; Prahalad & Doz, 1987). This balance is harder to achieve where corruption is high due to reduced understanding of appropriate practices and increased information asymmetries. Boyacigiller (1990) argued that host-country risk and uncertainty increases the need for PCNs. Indeed, the preoccupation with PCNs in the literature has persisted because they are seen to be easier to control and more reliable sources for the communication of headquarters’ policies to distant operations. Wederspahn and Daniel (1998) argued that US firms should use PCNs to create a global code of ethics, which could help minimize adverse effects of corruption. Doh et al. (2003) noted that corporate codes of conduct, training, development, and education increase the need for oversight to ensure subsidiaries follow these policies. Utilizing PCNs affords greater control over subsidiary practices (Boyacigiller, 1990; Edstrom & Galbraith, 1977; Jaeger 1983; Perlmutter, 1969) because they identify more closely with the MNC (Bjorkman, Barner-Rasmussen, & Li, 2004; O’Donnell, 2000). Further, Kobrin (1988) cautioned that significantly reducing PCN use could decrease corporate identity, compliance with objectives, and opportunities for developing international experience. While using PCNs may not eliminate opportunities for bribes and resource misappropriation, it likely reduces these risks because PCNs career paths are more dependent on corporate headquarters (Pfeffer & Salancik, 1978). Serving as the primary conduit for creating a common understanding of existing MNC routines, PCNs may be best suited to help subsidiaries avoid corruption-related problems. Together these arguments suggest MNCs may prefer using PCNs to manage subsidiaries where corruption is high.

**Proposition 1.** PCN use will increase in locations where corruption is high.

Despite the focus in much of the literature on deploying PCNs to achieve consistency and control in countries with risky environments, local adaptation may be more important as work routines are altered, especially in the presence of arbitrary corruption (Rodriguez, Uhlenbruck, & Eden, 2005). Doh et al. (2003, p. 116) documented various ways corruption, whether arbitrary or pervasive, can affect firms. Firms may be forced to pay bribes, even for services to which they are, in the words of Manion (1996, p. 168), “... fully entitled.” They may face bureaucratic delays as corrupt regimes impose obstacles in the path of routine business. They may be forced to engage in unproductive efforts, hide profit to avoid extortion by corrupt
officials, and to deal with organized crime in the process of doing business; all these activities likely hinder managerial control and make work less routine. Corruption also makes task programming harder and increases information asymmetries (Welbourne, Balkin, & Gomez-Mejia, 1995). Since corruption masks the rules of the game (North, 1991), it makes identifying and implementing local practices that mitigate corruption more elusive. Because HCNs have a superior understanding of local knowledge systems, they are better able to facilitate information spillovers and vicarious learning; this may be especially important for foreign subsidiaries unfamiliar with host-country social, cultural, and legal norms. The familiarity of HCNs with their tacit cultural and institutional norms make them better than expatriates at identifying and implementing practices that minimize exposure to corruption. Given short training periods and lengths of international assignments, it is often difficult for expatriates to develop a deep understanding of their host-country’s society, culture, and workplace regulations. Yet, identifying and successfully implementing accepted practices require a deep understanding of legal, cultural, and institutional norms (Edelman, 1990). Indeed, Mezias (2002) found that, although foreign subsidiaries faced more labor lawsuits than their domestic counterparts, subsidiaries using locals in key positions faced fewer labor lawsuits, a fact he attributed to their ability to better navigate the complex array of laws and regulations.

From a transaction costs perspective, Henisz and Zelner (2004) noted that firms benefit from navigating difficult policy environments, presumably including those characterized by corruption. HCNs can better navigate their country’s institutional environment, which may explain why researchers found that HCN managers minimized problems stemming from corruption (e.g., Mayrhofer & Brewster, 1996; Reynolds, 1997). Corruption may also exacerbate significant expatriate adjustment difficulties (Bhaskar-Shrinivas, Harrison, Schaffer, & Luk, 2005; Black & Porter, 1991; Leiba-O’Sullivan, 1999; Mezias & Scandura, 2005; Shaffer & Harrison, 1999; Shaffer, Harrison, & Gilley, 1999; Shaw, 1990; Takeuchi, Tesluk, Yun, & Lepak, 2005; Yosup & Larwood, 1983). Corruption likely increases costs associated with expatriate training and preparation (Black & Mendenhall, 1990; Tung, 1982), makes performance appraisal more difficult (Gregersen, Hite, & Black, 1996), and exacerbates problems of family adjustment (Caligiuri, Hyland, Joshi, & Bross, 1998; Shaffer & Harrison, 2001); all of these factors would reduce expatriate effectiveness. The conclusion of this line of argument is clear: HCNs better understand the local environment, helping MNCs overcome LOF concerns, such as those posed by corruption (Zaheer, 1995; Mezias, 2002).
Further, deploying PCNs may be particularly problematic for MNCs based in developed countries. For example, in the case of the United States, the Foreign Corrupt Practices Act (FCPA), passed in 1977, resulted in US firms facing a different legal environment than MNCs from other countries (Edelman & Suchman, 1997). Now US citizens are subject to legal risks at home when assigned to subsidiaries operating in countries where corruption is high. The Organization for Economic Cooperation and Development (OECD) passed similar regulations in 1999. Thus MNCs from the United States and OECD countries have legal reasons to consider alternatives to PCNs when staffing foreign subsidiaries in high corruption locales. Indeed, some researchers found evidence that home-country institutional environment affects country choices for FDI, especially when considering corruption (e.g., Cuervo-Cazurra, 2006). Together these arguments suggest MNCs may prefer using more HCNs to manage subsidiaries in countries with high corruption.

**Proposition 2.** HCN use will increase in locations where corruption is high.

High costs and risks associated with using PCNs may discourage their widespread use (Tarique et al., 2006). Using only PCNs or HCNs may create dysfunctions that limit efficient use of resources and lower morale (Zeira & Harari, 1977). A geocentric alternative is using TCNs, who increase cultural diversity in subsidiaries. Such diversity likely facilitates knowledge creation and transfer (Rhinesmith, 1992), which may help subsidiaries craft strategies to overcome liabilities of corruption. TNCs represent a relatively low-cost alternative to PCNs (Dowling, Schuler, & Welch, 1994). TCNs also know corporate policies, are typically more culturally sensitive and linguistically adroit than PCNs from the United States, and are more willing to accept international assignments because their domestic career options are typically more limited than PCNs (Reynolds, 1997). Because they have established careers working outside of their own country, TCNs may possess greater empathy and openness to local culture and institutions than PCNs (Dowling et al., 1994). Increased local sensitivity, tempered with international experience, could help TCNs maintain focus on MNC purpose and perspective regarding local practices, despite the presence of high levels of corruption. Increased use of TCNs may also provide greater potential for developing international experience, especially experience operating in uncertain, risky environments. Such experience may facilitate development and transfer of practices designed to reduce effects of corruption. These arguments imply that
MNCs should prefer using more TCNs to manage subsidiaries where corruption is high.

**Proposition 3.** TCN use will increase in locations where corruption is high.

*Corruption and Incentive Use*

A core insight of information economics and agency theory is that the use of incentive compensation rather than relying exclusively on fixed compensation creates opportunities to control and influence employee behavior, including the revelation of private information. These opportunities may be especially important for MNCs operating where corruption is high; indeed, many studies provide evidence that incentives can improve firm performance when operating in environments that facilitate employee opportunism and shirking (Khan, Dharwadkar, & Brandes, 2005; Lippert & Moore, 1995; Rajagopalan, 1997; Tosi & Gomez-Mejia, 1989). Welbourne et al.'s (1995) field study confirmed the value of performance-based compensation, specifically gain-sharing, as a means of aligning incentives. Shaw, Gupta, and Delery (2000) found evidence that incentive compensation helped overcome disadvantages such as corruption. Tosi, Brownlee, Silva, and Katz (2003), using a laboratory study, showed that incentive compensation aligned goals of firm owners and managers. Pendleton (2006) found evidence that British firms used incentive compensation in ways consistent with agency theory.

Using stock options to align incentives has also received considerable attention (e.g., Johnson, Hoskisson, & Hitt, 1993), although there is some evidence that using stock options to align incentives is somewhat more difficult than using payments tied to performance (Marco, Smith, & Fratto, 2004). For example, DeFusco, Zorn, and Johnson (1991) found that changes in stock options were not associated with improved market returns. Tucker and Kennedy-Tucker (2004) showed that CEO stock options did not improve performance at managed care firms. However, other studies have found evidence that stock options help focus managers and increase clarity of purpose in MNCs. St-Onge, Magnan, Thorne, and Raymond (2001) found evidence that stock options are adopted with the intent of aligning incentives. Andrews and Dowling (1998) found that stock options were associated with superior post-privatization performance. Schnabel (1993) showed that ownership incentives could help improve performance of real estate ventures. Barkema (1996) found that boards used both bonuses and stock options to adjust behaviors of Dutch top managers. Other studies
found that increased stock ownership encourages managers to act in a manner consistent with stockholder interests (Getz, 2002; Kosnik & Bettenhausen, 1992; Tosi, Katz, & Gomez-Mejia, 1997).

Thus, there is considerable evidence that both incentive compensation and stock options may help align incentives. Welbourne et al. (1995) noted that subsidiary management is harder when those working in the subsidiary have more information than those working at headquarters, and when tasks are difficult to structure. Since these conditions are more likely to hold for subsidiaries operating in high corruption environments, we believe that MNCs are more likely to use these kinds of incentive mechanisms in environments where monitoring is more difficult (Eisenhardt, 1988; Stroh, Brett, Baumann, & Reilly, 1996). Indeed incentive-based compensation keeps control of critical resources with headquarters, which helps exert greater control over subsidiary employees (Pfeffer & Salancik, 1978). This increased control may be especially important to MNCs where corruption is high, an argument that is consistent with the Towers Perrin, 2005–2006 Worldwide Total Remuneration study finding that MNC incentive pay packages have become more customized by location (Towers Perrin, 2006).

These observations from the world of practice are echoed in theoretical models. Bac (1996, p. 297) argued that the “...incentive system can be focused exclusively on minimizing external corruption.” As his model showed, corrupt environments are harder to manage (Manion, 1996), a theoretical claim that received support from anecdotal evidence. Crangle (1998) found that some firms operating in Eastern Europe, where corruption is high, switched to incentive-based compensations to help motivate managers to battle corruption and mitigate its effects. From our perspective, this literature implies that as the institutional logic of “agency” (Jones, Felps, & Bigley, 2007) confronts global realities of corruption in MNC operations, incentives become a tool to minimize the effects of this LOF.

In developing organizational exchange theory, Griesinger (1990) detailed how organization survival depends on offering inducements that compare favorably with alternatively available inducements (e.g., bribes). Such inducements create stakeholder dependence on the firm (Pfeffer & Salancik, 1978). Creating inducement-based dependencies may be especially important for MNCs operating where corruption is high for at least two reasons (Goel & Rich, 1989). First, bribes and resource misappropriation represent alternative inducements that are more likely in such locations. Second, the relative salary levels of bribe givers and takers were found to be a major factor influencing corruption. We conclude that incentive compensation
may be an important strategy to mitigate the LOF created by corruption; therefore, we predict:

Proposition 4A. Bonus payments will increase where corruption is high.

Proposition 4B. Stock options will increase where corruption is high.

**Corruption and Internal Control**

International management research has suggested that an increased need for monitoring subsidiary operations is related to differences in operating environments. For example, Roth and O'Donnell (1996) found that cultural distance between home and host countries had a significant effect on subsidiary strategies. Chang and Taylor (1999) found that cultural distance between an MNC's home country and Korea significantly affected control mechanisms manufacturing subsidiaries used. These arguments are consistent with the classic agency argument: monitoring prevents agents from engaging in moral hazard, shirking, and opportunism (Fama, 1980; Fama & Jensen, 1983; Jensen & Meckling, 1976). Shaw et al. (2000) found evidence that monitoring helped resolve agency problems; as did Pendelton (2006), whose evidence came from a sample of British firms. Hayes, Tiessen, Waterhouse, and Cooper (1983), although critical of agency theory, recognized its applicability to accounting systems and internal control. The need for coordination and control increases with information asymmetries (Welbourne et al., 1995), and when creating a common identity across subsidiaries is more difficult (Towry, 2003). Corruption not only increases information asymmetries and external uncertainty, but it also increases internal uncertainty because subsidiary employees, who have greater opportunities to shirk and engage in opportunism, are more unpredictable (Calhoun, 2002).

From an information processing perspective, Galbraith (1973) argued that organizations adapt in response to growing complexity. As complexity grows, firms must increase information processing capacity by using people more intensively in information processing roles. One MNC adaptation to offset the increased complexity and information asymmetries stemming from corruption is to add more auditing and control positions, and integrating more control activities where corruption is high. Indeed, research by Alam (1995) suggests that accounting and managerial skills are possibly correlated with corruption. Shleifer and Vishny (1993) argued that a first step in reducing corruption should be to create accounting systems to prevent
resource misappropriation. Sun (1999) noted that good accounting systems in China lower corruption, primarily because tracking helps identify egregious behavior. This is consistent with Jones (1984), who argued that individuals are more likely to shirk when performance is less visible. Thus, we expect that MNCs will respond to high corruption by creating more auditing and control positions in the hierarchy.

**Proposition 5.** Use of control positions will increase where corruption is high.

**Corruption and the Scope of Activities**

Early FDI research on disadvantages of foreignness stems from internalization theory (Hymer, 1976; Kindleberger, 1969), which is rooted in transaction costs of firms. A central tenet of transaction cost economics is that when market transactions costs are greater than costs associated with internalizing that transaction, firms will integrate those activities to reduce costs and uncertainty (Coase, 1937). In general, the reverse is also true, that firms will tend to reduce internal activities as the transaction costs of those activities increase (Williamson, 1991). These insights may apply to the case of MNCs in high corruption environments: the LOF that result may cause firms to decrease the scope of their activities relative to locations where corruption is low. As Caves (1982) suggested, it may cost more for a foreign firm to perform particular activities than it does for a local firm; further, the relative probability for success may be lower for foreign firms (Casson, 1979), especially as LOF increase information asymmetry and uncertainty. Consistent with these arguments, Mezias (2002) noted reluctance on the part of foreign firms to have human resource officers at many of their US foreign subsidiaries despite evidence of facing a LOF with respect to labor lawsuits in the United States. Calhoun (2002) argued that MNCs may restrict the amount of internalization where corruption is high because successive integrations increase uncertainty while reducing contract enforceability. Also, as a firm increases its scope of operations it increases in size, which may further increase its exposure to LOF. Indeed, size has been correlated with increased negative bias/discrimination associated with foreignness (Cai & Warnock, 2004; Kostova & Zaheer, 1999). Thus we expect foreign subsidiaries to restrict the scope of their operations where corruption is high.

**Proposition 6.** MNC will restrict the scope of operations where corruption is high.
DISCUSSION AND CONCLUSION

As Doh et al. (2003) and Rodriguez et al. (2006) noted, understanding how firms cope with corruption remains an open question. Our purpose has been to advance research that explores how firms manage in locations characterized by high levels of corruption. Past corruption research focused primarily on country-level effects and their impact on initial investment decisions of MNCs. These findings strongly suggest that corruption deters FDI, which is an important finding with clear policy implications (Habib & Zurawicki, 2002; Mauro, 1995; Wei, 2000; Wei & Shleifer, 2000). Given that some firms enter countries characterized by high levels of corruption, however, there is a greater need for research examining challenges of operating in countries with high levels of corruption. Toward this end, we developed theoretical propositions investigating firm-level strategic responses to corruption. A second contribution of this research is linking corruption to LOF, which we did by arguing that corruption represents a powerful LOF. This framing suggests a focus on how antecedents and effects of corruption may impact management of foreign subsidiaries. Taking this focus, we developed theoretical arguments for why some MNC strategies might vary with corruption. The LOF perspective is particularly useful in this regard because: (1) its tradition is investigating conditions that disproportionately affect foreign subsidiaries, and (2) it affords integration of several theoretical perspectives to provide a more holistic assessment of specific strategies for mitigating LOF such as corruption (Zaheer, 2002). Accordingly, we developed theoretical propositions that incorporate findings and arguments from an extensive range of theories subsumed under the umbrella of the LOF perspective. These propositions about MNC strategies designed to mitigate effects of corruption provide some insight into challenges of managing subsidiaries in high-risk environments. Future research examining whether these propositions are supported is required. We hope our arguments spur future studies directly investigating how MNC strategies minimize threats from corruption and other LOF faced by their foreign subsidiaries.

An important implication for future research stems from our arguments about subsidiary staffing strategies. While empirical confirmation is needed, our theoretical arguments suggest an alternative to the dominant assumption that headquarters control of foreign subsidiaries can be measured exclusively in terms of PCN use (O'Donnell, 2000). By taking a broader lens on which personnel might enhance monitoring, we hope others explicitly test alternate hypotheses that HCNs and TCNs may be effective in managing subsidiaries in challenging environments. Such examinations may
help explain why Bjorkman et al. (2004) did not find an association between using PCN top managers and knowledge transfers between parent and subsidiary. Empirical research on whether firms prefer PCN, HCNs, or TCNs to manage foreign subsidiaries in challenging contexts is needed.

The issue of how firms use expatriate managers is made even more complex if firms change their monitoring approach over time. Beamish and Inkpen (1998) provided evidence that Japanese firms, known for the rice-paper ceiling that kept PCN expatriates in power at overseas subsidiaries (Kawakami, 1996), have begun to use more HCNs. They argued that these firms realize the importance of empowering local managers and are thus becoming more truly global. This suggests that future studies clarifying the role of expatriate managers in managing foreign subsidiaries likely need to be longitudinal (Wang & Bansal, 2005). Another consideration as to why HCNs might be preferred for foreign subsidiary management is related to the home-country institutional environment. Because focal firms may be from the United States or Europe, PCN expatriates are bound by the FCPA or similar European Union legislation. Although PCN expatriates may be more embedded in MNC culture and better understand the MNC mission and goals than host-country employees, these are not the sole considerations. Limiting expatriate use in high corruption countries may be a strategy to minimize risks of running afoul of FCPA or similar European Union legislation.

Future research to enhance understanding of when incentives, for example bonus pay and stock options, help curb corruption in MNCs is warranted. We provide a theoretical rationale for utilizing bonuses and stock options to reduce bribes and resource misappropriation, but there may be substantial differences in the effectiveness of bonus and stock option use to curb effects of corruption. Finally, we need to better understand when these strategies can improve subsidiary and MNC performance. Future research investigating these issues has the potential to improve theoretical and empirical understanding of MNC compensation strategies, as well as to provide vital practical advice for managers of foreign subsidiaries.

Maintaining subsidiary control in risky, uncertain environments is critical to MNC performance. Our propositions related to auditing and control activities, as well as extent of integration, have implications for future research. While past research indicates that LOF provides good reason for MNCs to be reluctant to expand quickly and internalize numerous activities, there is need to swiftly incorporate auditing and control functions into subsidiaries. MNCs can balance the need to integrate auditing and control activities with a strategy to limit expansion into other activities when facing LOF. Future empirical analyses can increase understanding of how
monitoring and level of expansion affect subsidiary performance, especially in terms of mitigating corruption and other serious LOF.

It will be important to assess how these different proposed strategies overlap, complement, or contradict one another. MNC identity and culture are strongly influenced by ability to harmoniously integrate PCNs, HCNs, and TCNs. A sense of community and common purpose greatly enhance MNC performance (Ireland, Ramsower, & Carini, 1993) by encouraging more employees to accept responsibility for outcomes (Ireland & Hitt, 1999). Incentives and monitoring can help MNCs achieve these goals, but these have potential drawbacks: incentives can create mercenary expectations, and monitoring can stifle innovation. While expansion may expose subsidiaries to greater LOF, it is often needed to exploit competitive advantages. Lastly, successful employee integration, as well as balanced incentive and monitoring strategies, will strongly determine success of internalization and expansion. Thus, we encourage research designs that simultaneously investigate these critical strategies.

Although there is a paucity of research examining connections between LOF and entry mode, many FDI theorists argue that MNCs entering countries substantially different (on a variety of dimensions) from their home countries are more likely to use and benefit from collaborative entry modes (e.g., Johanson & Vahlne, 1977; Kogut & Singh, 1988). Taking locals partners is thought to reduce LOF. However, LOF do not necessarily decrease faster for firms operating in culturally similar countries. Evans, Lane, and O’Grady (1992) argued that firms overestimate similarities across countries with common language, history, and legal traditions. Similarly, Petersen and Pedersen (2002) argue that firms underestimate LOF across such countries. Their examples of poor performing Canadian retailers operating in the United States suggest differences between these countries were more profound than managers had expected (Petersen & Pedersen, 2002).

More specific to our research, Uhlenbruck et al. (2006) established that corruption makes wholly owned entry strategies less likely. However, we argue that some MNCs establish wholly owned subsidiaries in countries with high corruption, and our propositions are largely tailored to subsidiaries established via this entry mode. We believe the wholly owned entry mode provides the best opportunity for direct organizational learning about LOF. Taking partners likely encourages “outsourcing” subsidiary problem solving to local partners or, at best, affords vicarious learning from observing local partners. In-depth international experience may require direct involvement and control of subsidiary management necessitated by wholly owned market entry. While there is evidence that LOF decrease over
time (Zaheer & Mosakowski, 1997), it is important to examine how entry mode affects the rate of learning and thus mitigation of LOF.

A final implication for future research is related to measuring corruption. Habib and Zurawicki (2002, pp. 296–297) noted little consensus among researchers on how to measure corruption and constructs like political risk and cultural distance, which tend to be highly correlated. For our purposes, we focused on corruption as a theoretical construct and argued it would affect critical MNC strategies. Since many forms of cultural or institutional distance likely increase LOF, we were not focused on making a strong distinction between dimensions of corruption (e.g., Barkema & Vermeulen, 1997). Determining the best indicators of specific outcomes, in terms of dimensions of corruption (Uhlenbruck et al., 2006) or in terms of corruption as opposed to related constructs such as cultural distance, political risk, or institutional openness (Peng, 2003), is beyond the scope of our paper. Whether one or more dimensions of corruption or aspects of corruption correlated with other constructs (e.g., political risk or institutional openness) will alter proposed effects is left for future research. Nonetheless, dimensionality of corruption and empirical relationships between corruption and other measures of how countries differ are important to enhance understanding of how firms adapt to global institutional realities (Geletkanycz, 1997). Future research on dimensionality and meaning of multiple measures of corruption and related constructs in data collected by Transparency International, the World Bank, or other organizations is warranted.

Corruption will remain an important topic in international business research despite the fact that MNCs may prefer to avoid ambiguous and uncertain environments. As economic opportunities for investment in emerging economies with high levels of corruption (e.g., China and India) increase, so too will FDI. By developing theoretical insight into how a range of strategies might help minimize effects of corruption, we provide a foundation for practical implications for managers trying to resolve problems arising from corruption. Future research can enhance the usefulness of this information by testing and linking these propositions with performance. We hope our theoretical arguments act as a first step toward identifying best practices, as well as motivating and assisting future research in this important area.

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LIABILITY OF FOREIGNNESS: NEW INSIGHTS FROM CAPITAL MARKETS

R. Greg Bell, Igor Filatotchev and Abdul A. Rasheed

ABSTRACT

Liability of foreignness (LOF) has been one of the central constructs in the field of international business and management. Over the past two decades, a significant body of theoretical and empirical research has accumulated, theorizing on the sources of these LOFs, investigating their magnitude, and prescribing approaches to mitigate these disadvantages. However, much of this research is almost exclusively related to firms expanding their products, services, and operations to other countries as part of their global expansion. The difficulties firms face in foreign product markets is just one dimension of the costs they can face in their attempts to secure resources abroad.

We expand the domain of the LOF construct to include liabilities faced by firms accessing foreign capital markets in light of the increasing integration of capital markets. We identify four sources of LOF in capital markets: regulatory costs, information costs, unfamiliarity costs, and costs arising out of cultural differences. Based on an extensive review of “home bias” in equity markets, we propose four strategies to erase the
INTRODUCTION

Theoretical scholars working in the fields of international business and management have, for many years, argued that foreign firms face disadvantages in host countries, compared to domestic firms (Caves, 1971; Hymer, 1976). These disadvantages are generally referred to as “liabilities of foreignness” (LOFs). A significant body of theoretical and empirical research has accumulated in recent years hypothesizing as to the sources of these liabilities, investigating their existence and magnitude, as well as prescribing approaches to mitigating these disadvantages. However, much of this research is almost exclusively related to firms expanding their products, services, and operations to other countries as part of their global expansion. As a result, LOFs are usually associated with the local lack of knowledge of the foreign firm’s products and brand, cultural differences in management practices, etc. Although this may have been appropriate and adequate in an era when globalization was understood almost exclusively as the globalization of product markets, the increasing integration of capital markets makes it imperative to study the prevalence of LOFs in capital markets as well. The objective of this paper is to expand the domain of the LOFs construct to include liabilities faced by firms accessing foreign capital markets.

The accelerating pace of global capital market integration in the last two decades has had a profound impact on the strategies pursued by firms, including their strategies for accessing capital resources. Cross-border capital flows manifest in a variety of ways such as foreign portfolio investment, foreign direct investment, cross-border acquisitions, cross-listings, and foreign initial public offerings. Interestingly, reductions to the regulatory barriers to trading, clearing, and settlement across borders have exposed national stock exchanges to genuine competition (Lee, 2002). Just in the last decade, new exchanges and new financial instruments have enabled firms to link with investors all over the world. With the lowering of institutional barriers, publicly held corporations now routinely cross-list
their equity shares on exchanges outside their home markets. In addition, a
growing number of entrepreneurial and former state-owned entities are
choosing to forego their local capital markets altogether and undertake their
Initial Public Offers (IPOs) in foreign stock exchanges. Venture capital is
also moving across borders at an unprecedented rate with global non-US VC investing reaching nearly $25 billion in 2007 (Source: SDC Platinum
Venture Economics).

Securing resources is critical to the success of a wide array of organiza-
tions, including MNCs, entrepreneurs, former SOEs, and venture capital
firms. While international business scholars have, to date, focused on the
additional costs which firms face in foreign markets, most of the attention
has been in understanding the costs firms incur in foreign product markets.
Surprisingly, prior research is characterized by inadequate attention to factor
markets such as capital and labor markets. The finding by Mezias (2002) that
foreign firms face more labor lawsuits judgments in the United States
compared to domestic firms demonstrates that the domain of the liability of
foreignness (LOF) construct extends to labor markets as well. The need
to study the internationalization of capital markets was eloquently made

... it is interesting to speculate on the idea that MNCs can internationalize with regard
to the capital markets, to parallel the classic line of thinking about internationalization
vis-à-vis the product markets (Johanson & Vahlne, 1977). MNCs have a range of
ways in which they can increase their visibility and relationships with major shareholders
and financial institutions, from depositary receipts through a full overseas listing to
a relocation of the corporate HQ to a global financial center. While different in many
ways, these approaches can be viewed as a series of steps, each involving a higher
investment and a greater level of commitment to the global capital markets, but offering
important rewards in terms of the costs of borrowing, the liquidity of the stock, and the
effectiveness of the MNC’s corporate governance.

Navigating the dynamic international capital market environment and
attracting capital market participants located in dissimilar cultural and
institutional environments is a difficult challenge facing the international
manager. Just as managers must contend with LOFs in product markets,
they must also be aware of the sources of the similar LOFs in capital markets
and be prepared to strategically mitigate the resulting costs. If LOFs are
prevalent in the capital markets, it has implications for a firm’s cost of capital
and firm value (Stulz, 1999). Hence, the primary objective of our paper is to
expand the scope of the LOF literature to include the liabilities faced by a
firm entering capital markets outside its home country. Although capital
markets include both equity and debt markets, the majority of our discussion
is restricted to equity markets since a rapid integration of equity markets was the most pronounced globalization phenomenon over the past decade.

We begin the paper by reviewing the extant literature on LOF to identify the different sources of such liabilities and to assess the cumulative empirical evidence on the prevalence of LOF in different industries. This is followed by a brief review of the state of international capital markets and their increasing worldwide integration. We then identify and elaborate on a number of sources of LOF and enumerate a variety of strategies that firms can pursue to mitigate LOF and gain legitimacy in international capital markets. We conclude by explaining the various manifestations of LOF in capital markets and offer a research agenda for the future investigation of LOF in capital markets.

**LIABILITY OF FOREIGNNESS: THEORETICAL BACKGROUND**

The origins of the concept of LOF can be traced back to the works of Hymer (1976) and Kindleberger (1969) who laid out the theoretical reasons why foreign firms are likely to incur costs that local firms would not incur, and face competitive disadvantages. LOF is considered as the “fundamental assumption driving theories of the multinational enterprise” (Zaheer, 1995, p. 341). Despite its theoretical centrality to the theories of multinational enterprise, from a conceptual and empirical point of view, LOF languished for many years “as a taken-for-granted assumption” (Zaheer, 2002) in the international management literature. Starting in the mid-1990s, we have seen a significant revival and renewed recognition in terms of both theoretical development (Eden & Miller, 2004; Zaheer, 2002) and empirical research (Miller & Parkhe, 2002; Nachum, 2003). The *Journal of International Management* published a special issue focusing on LOF in 2002, providing a forum for discussion and debate on the theoretical domain of the LOF construct, its operationalization and measurement, and strategies for mitigating LOF. The most widely used definition of LOF in the literature is provided by Zaheer (1995, p. 343) who considers LOF as “all additional costs a firm operating in a market overseas incurs that a local firm would not incur.” Hennart (1982, p. 2) notes that “operation in a foreign country will usually entail higher costs, everything else being equal, than operation at home.” The study of systematic liabilities encountered by populations of firms due to factors that are by and large out of their control has parallels in
population ecology research where considerable attention has been paid to the twin concepts of liabilities of newness (Stinchcombe, 1965) and liabilities of smallness (Hannan & Freeman, 1977; Mitchell, 1995). Given the conceptual similarities between LOF and these other types of liabilities, Zaheer and Mosakowski (1997, p. 440) suggest that “liability of foreignness might need to stand alongside the other liabilities of age and size.” Bearing in mind that there is considerable consensus among scholars that operating in a foreign country involves additional costs, researchers have tried to answer three fundamental questions. First, what are the sources of these additional costs that a foreign firm would incur that a local firm would not incur? Second, why do firms engage in foreign expansion despite the prevalence of these costs that put them at a competitive disadvantage relative to local firms? Finally, what can firms do to overcome the costs associated with LOF?

Based on a review of prior literature, Zaheer (1995) identified at least four sources of costs that put a foreign firm at a competitive disadvantage with local firms. First, there are spatial costs, which relate to costs arising from transportation and coordination. Even in a world where technology has shrunk distance and time, these costs are nontrivial (Ghemawat, 2001). Second, there are costs that arise because of a firm’s unfamiliarity with the local environment. As Caves (1971, p. 5) points out, “the foreign firm must pay dearly for what the native has acquired at no cost to the firm ... or can acquire more cheaply” as a result of its knowledge of the host country. Third, there are costs resulting from the host country environment due to the lack of legitimacy of the foreign firm as well as the prevalence of economic nationalism in many countries. The boycott of French products in the USA in the aftermath of the Iraq war or the Japanese government making only Japanese cars eligible for its equivalent of the “cash for clunkers” program are recent examples of economic nationalism impacting consumer behavior. In addition, local consumers may not be familiar with the foreign firm’s brand and products, and they would lean toward buying more familiar local brands even when their quality and prices do not match foreign entrants. Finally, there are costs arising out of the home country environment as well. These may take the form of restrictions on high-technology exports, embargos on trade, and investment against specific countries, etc.

There has been confusion in the literature about the use of two interrelated terms, namely, cost of doing business abroad (CDBA) and LOF. Debate has centered on whether these two concepts are synonymous, whether one is a subset of the other, or whether one leads to the other. Alternately, did one morph into the other through popular usage as implied
by Luo and Mezias’s (2002) suggestion that CDBA was a precursor to LOF? Both Zaheer (2002) and Eden and Miller (2004) have provided valuable conceptual clarification regarding the domain of these constructs. Zaheer (2002) notes that while market-driven costs are central to CDBA, LOF relates to the subtler structural/relational and institutional costs. Structural/relational costs arise from a foreign firm’s network position in the host country and its linkages to important local actors. Most likely, a local firm would incur fewer of these costs because it has better developed local networks. Institutional costs arise from institutional distance between the home and host countries, and higher the institutional distance, the lower the legitimacy of the foreign firm. Thus, LOF is different from CDBA in the sense that it focuses on the “social costs of access and acceptance” (Zaheer, 2002, p. 352), whereas CDBA relates to market-driven economic costs.

Unlike Zaheer (2002) who sees CDBA and LOF as two distinct types of costs, Eden and Miller (2004) see LOF as a key component of CDBA because social costs are one of the many costs that a firm incurs while doing business abroad. These social costs rise from unfamiliarity, relational, and discriminatory hazards with institutional distance as the key driver behind each of these costs. Unfamiliarity costs result from a firm’s lack of knowledge of, or experience in, the host country. Discrimination hazards arise from discriminatory treatment by the host government in a variety of ways ranging from discriminatory taxation to discriminatory procurement. It can also surface in discriminatory treatment by customers in the host country who may prefer a local product out of nationalistic reasons or dislike products from a foreign country for historical reasons (e.g., Japanese cars in Korea). To a great extent, the discrimination hazards arise from the “legitimacy deficit” (Schmidt & Sofka, 2009) faced by a firm in a foreign country. Relational hazards relate to the higher costs that a foreign firm would incur with respect to both internal organization and external market transactions.

If a firm incurs both market-driven costs and social costs in operating abroad, the obvious question is why would a firm decide to go abroad? The answer to this question is at the heart of theories of internationalization. A simple answer is that a firm should expand abroad only if it possesses resources or capabilities that are specific to the firm that compensate for the LOF. Caves (1971, p. 5) stated this more formally by arguing that the foreign firm “must enjoy some specific competitive advantage associated with a particular asset and must find production abroad preferable to the alternatives.” The firm-specific advantage explanation for internationalization was subsequently incorporated into Dunning’s (1979) eclectic paradigm as ownership advantages. In other words, an international expansion
presents the firm with a cost–benefit trade-off related to benefits of accessing new markets and associated costs of LOF. Only firms that are able to manage this trade-off are successful in their global expansion.

Considerable recent empirical research has concentrated on the question of what firms can do to overcome LOF. Zaheer (1995) suggested local isomorphism as a possible response. This approach requires the firm to mimic the administrative practices of local firms. In a similar vein, Mezias (2002) found that foreign firms who used American top officers or whose parent firms had more US operations faced fewer labor lawsuit judgments. Eden and Miller (2004) and Chen (2006) suggest that the negative effects of LOF can be reduced by appropriate entry mode choice. Similar results are reported by Haiyang, Griffith, and Ru (2006). Luo, Shenkar, and Nyaw (2002) discovered that foreign firms entering China reduced their LOF by a combination of offensive (networking, legitimacy improvement) and defensive (contracts, guanxi) strategies. Both Eden and Molot (2002) and Nachum (2003) suggest that the key to overcoming LOF is to use firm-specific resources to outperform local rivals based on studies of auto and financial service industries, respectively. Elango (2009) found that foreign insurance companies in the USA coped with LOF by greater boundary spanning and adoption of differing strategic postures.

Zaheer (2002) argues that LOF is an inherently dynamic concept. That is, LOF can change with the passage of time. Over time, as a firm becomes an insider in a country, LOF might decline or disappear. For example, Hindustan Lever (the Indian subsidiary of Unilever) and ITC (the Indian subsidiary of Imperial Tobacco Company) are two examples of foreign firms that have attained insider status in their host country as a result of their long history and specific strategies.

Because strategic decisions relate to issues of domain selection and domain navigation (Bourgeois, 1980), it is not surprising that much of the research in the international business, strategic management, and entrepreneurship areas pertains to the product market strategies pursued by firms and the liabilities they face when operating abroad. Certainly, the strategies that firms pursue in the product market domain are one of the most important decisions that a firm will make. However, firms often need external financial resources in order to capitalize on growth opportunities provided by their chosen product markets. In response to the worldwide integration of capital markets, firms of all sizes are increasingly looking abroad to source equity and debt resources. In the next section, we discuss how changes in the world’s financial markets have made it easier for firms around the world to source equity and debt capital outside of their home
markets. Yet, despite the growth in listing venues and diversity of capital-raising instruments, firms around the world face pervasive challenges in securing capital resources from foreign investors.

**INTERNATIONAL CAPITAL MARKETS TODAY**

Today the largest international capital markets are in New York, London, and Tokyo. However, the competitive landscape across stock exchanges around the world, and especially across Europe, has changed considerably in recent years. Much of the changes can be traced to the dramatic decreases in the obstacles to international portfolio investment. Thirty years ago most countries had restrictions on foreign exchange transactions that limited cross-border portfolio investment. However today, few developed countries have such restrictions now and many emerging countries are eliminating them. As a consequence, firms around the world can take a more strategic approach to their capital-raising activities. For example, the 2010 decision of Russian steelmaker, Severstal, to list on the Hong Kong Stock Exchange is evidence of the growing importance of Asian stock markets for companies in emerging economies. These institutional changes in the financial markets have helped foster the worldwide expansion of foreign investment in MNCs, entrepreneurial ventures, and in former SOEs. Table 1 provides a snapshot of the listing and delisting activity of firms on stock exchanges outside their home markets. Although this table is from a single year, 2007, it is indicative of the growing number of firms seeking equity resources in foreign capital markets. Figs 1 and 2 reveal international capital-raising activities in equity and debt markets.

One of the biggest developments that have facilitated the entry of small- and medium-sized firms into global capital markets is the establishment of stock exchanges in several major financial centers requiring lower levels of transparency of listed firms. For example, Britain’s London Stock Exchange offers firms a choice between a “premium” or less onerous “standard” regime, as long as they tell investors clearly which one they have chosen. While premium listings have to meet Britain’s “super equivalent” standards, which the Financial Services Authority says are higher than the European Union’s minimum requirements, standard listings are much less regulated and more attractive to foreign companies. In 1995, the alternative investment market (AIM) was established to cater to the capital demands of small- and medium-sized firms. A number of the world’s exchanges have started new trading platforms modeled after London’s AIM. In 2000, the
Euronext market began with the merger of the Brussels, Amsterdam, and Paris stock exchanges. Today, the Euronext exchange is divided into the Eurolist, Alternext, and Marche Libre exchanges. The Alternext, with its more simplified listing requirements, was established in 2005 and modeled after London’s AIM. Similarly, the Borsa Italiana and the Deutsche Borse exchanges have restructured recently to offer firms a number of new venues to raise capital. Following a consolidation of its markets in 2008, the Borsa Italiana introduced in early 2009 the AIM Italia. In Germany, the Deutsche Borse is now divided into three main markets, the Amtlicher, Geregelter, and Freiverkehr. While the differences between the Amtlicher and Geregelter are slight, the Freiverkehr is modeled after the AIM and Alternext with lower listing requirements. Like London’s AIM and the Euronext Alternext, the predominate shares, bonds, and warrants listed on the Freiverkehr are from foreign countries. Following lengthy negotiations,

### Table 1. Number of Newly Listed and Delisted Companies (2007).

<table>
<thead>
<tr>
<th>Exchange</th>
<th>Listings</th>
<th></th>
<th></th>
<th>Delistings</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>Domestic</td>
<td>Foreign</td>
<td>% Foreign</td>
<td>Domestic</td>
<td>Foreign</td>
</tr>
<tr>
<td>Americas</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mexican Exchange</td>
<td>4</td>
<td>59</td>
<td>94</td>
<td>12</td>
<td>20</td>
<td>63</td>
</tr>
<tr>
<td>NASDAQ OMX</td>
<td>258</td>
<td>32</td>
<td>11</td>
<td>303</td>
<td>45</td>
<td>13</td>
</tr>
<tr>
<td>NYSE Euronext (US)</td>
<td>84</td>
<td>42</td>
<td>33</td>
<td>160</td>
<td>72</td>
<td>31</td>
</tr>
<tr>
<td>TSX Group</td>
<td>381</td>
<td>27</td>
<td>7</td>
<td>239</td>
<td>10</td>
<td>4</td>
</tr>
<tr>
<td>Asia-Pacific</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australian SE</td>
<td>276</td>
<td>16</td>
<td>5</td>
<td>93</td>
<td>11</td>
<td>11</td>
</tr>
<tr>
<td>New Zealand Exchange</td>
<td>11</td>
<td>2</td>
<td>15</td>
<td>7</td>
<td>7</td>
<td>50</td>
</tr>
<tr>
<td>Singapore Exchange</td>
<td>20</td>
<td>56</td>
<td>74</td>
<td>10</td>
<td>8</td>
<td>44</td>
</tr>
<tr>
<td>Tokyo SE Group</td>
<td>65</td>
<td>3</td>
<td>4</td>
<td>67</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Europe–Africa–Middle East</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deutsche Börse</td>
<td>94</td>
<td>115</td>
<td>55</td>
<td>NA</td>
<td>NA</td>
<td>22</td>
</tr>
<tr>
<td>London SE</td>
<td>270</td>
<td>141</td>
<td>34</td>
<td>289</td>
<td>83</td>
<td>22</td>
</tr>
<tr>
<td>Luxembourg SE</td>
<td>1</td>
<td>18</td>
<td>95</td>
<td>3</td>
<td>15</td>
<td>83</td>
</tr>
<tr>
<td>NASDAQ OMX Nordic Exchange</td>
<td>90</td>
<td>4</td>
<td>4</td>
<td>33</td>
<td>0</td>
<td>0</td>
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<tr>
<td>NYSE Euronext (Europe)</td>
<td>81</td>
<td>11</td>
<td>12</td>
<td>57</td>
<td>43</td>
<td>43</td>
</tr>
<tr>
<td>Oslo Børs</td>
<td>44</td>
<td>14</td>
<td>24</td>
<td>21</td>
<td>4</td>
<td>16</td>
</tr>
<tr>
<td>Warsaw SE</td>
<td>93</td>
<td>12</td>
<td>11</td>
<td>13</td>
<td>1</td>
<td>7</td>
</tr>
</tbody>
</table>

Euronext merged with the NYSE Group to form NYSE Euronext in April 2007. Other exchanges, such as Prague, Hong Kong, and Singapore, have also subdivided their primary markets to compete for small- and medium-sized firms attempting to acquire capital resources.

In addition to the growth in exchanges that enable firms to raise capital while maintaining lower levels of transparency, there has been considerable growth in networks of stock exchanges across Europe as well as new avenues for foreign firms to raise capital in the USA. For example, the NorexAlliance, the OMX in the Nordic and Baltic countries, and the use of Xetra trading system is spreading from Frankfurt to Dublin, Vienna, Prague, Bratislava, Budapest, and Malta.

In the USA, firms have a growing number of new financial vehicles that can be used to raise capital, such as the issuance of Depository Receipts and Rule 144A listings. The Securities and Exchange Commission (SEC) adopted Rule 144A as a safe harbor exemption from SEC registration requirements for resales of certain restricted securities to qualified institutional buyers by persons other than issuers. Specifically, it applies to securities of domestic and foreign issuers that are not listed on a US securities exchange. Rule 144A was designed to improve liquidity and efficiency of private placement market by offering more freedom to institutional investors to trade restricted securities, and to encourage foreign companies to sell securities in the US capital markets. This capital-raising avenue has become quite popular for foreign companies in particular, because it allows them to access the US

Fig. 1. Domestic and Foreign Listed Firms, End 2007. Source: World Federation of Exchanges.
In the wake of Sarbanes–Oxley legislation, foreign firms may consider this capital-raising vehicle to be a quite viable alternative to a direct listing on the NYSE and NASDAQ. Seven of the top 10 global IPOs in 2006 included a Rule 144A offering, and of the top 20 global IPOs in 2006, 6 were from Central and Eastern Europe, and all but one of these included a Rule 144A offering (Ernst & Young, 2007).

Despite the integration of capital markets, and the lowering of formal institutional barriers to foreign ownership of firms around the world, it has been found that investors do not take advantage of the diversification

Fig. 2. Domestic and Foreign International Debt Issuers, 2004–2005. Note: Domestic and foreign issuers of international corporate bonds are shown as a percentage of the total number of international bond issues between January 1, 2004 and June 30, 2005, as available from Bloomberg’s underwriter league tables. International bonds are Eurobonds and Euro-MTNs. An issuer of a bond is defined as foreign if its country of domicile is other than the country where the exchange is located. For international bonds listed on Euronext, the issuer is “domestic” if its country of domicile is France, Netherlands, Belgium, or Portugal. Source: Oxera calculations based on Bloomberg. Reproduced with permission from the City of London. http://secure-uk.imrworldwide.com/cgi-bin/b?cg = downloadse&ci = cityoflondon&tu = http://217.154.230.218/NR/rdonlyres/0C0CC6CF-8485-47A3-A58C-8218DDF4EE3A/0/BC_RS_costcapital_0606_FR.pdf
benefits of foreign stocks (Ahearne, Grieaver, & Warnock, 2004; Cooper & Kaplanis, 1994; French & Poterba, 1991; Tesar & Werner, 1995). In fact, studies have shown that US investors hold about 91 percent of their stock investments in domestic stocks – despite the fact that US stocks represent only 49 percent of the world market portfolio (French & Poterba, 1991; Pinkowitz, Stulz, & Williamson, 2001; Stulz & Williamson, 2003). Economic theory suggests that investing in countries in which the rate of return to investment is weakly correlated with that of the home market diversifies an investor’s portfolio and reduces investment risk and will therefore maximize returns. Moreover, unlike the trade in goods, transactions in financial markets do not incur spatial costs as there are virtually no transportation costs. Yet, a growing body of literature in finance demonstrates that foreign firms must contend with the existence of a “home bias” (French & Poterba, 1991) among investors. Home bias refers to the overweighting of domestic securities and underweighting of foreign securities in investment portfolios. The phenomenon that both professional and individual investors hold too small portions of their wealth in foreign assets has been documented in the finance literature at least since Levy and Sarnat (1970), Lessard (1973, 1976), and Solnik (1974). Many authors, including French and Poterba (1991), Tesar and Werner (1994, 1995), and Cooper and Kaplanis (1994) show this preference for domestic over foreign assets for investors in several countries and Chan, Covrig, and Ng (2005) show that the phenomenon is pervasive across 48 developed and developing countries worldwide.

Why would investors, who are assumed to be rational, forego the obvious benefits of portfolio diversification and continue to invest most of their funds in home markets? More importantly, how does the pervasive “home bias” phenomena impact the costs firms incur in their international capital-raising activities? A number of explanations have been offered for this puzzling persistence of such suboptimal behavior by investors, and these explanations provide valuable insights regarding the liabilities faced by firms in capital markets. In the following sections, we explore the home bias phenomena in capital markets, identify its sources, and present some potential strategies that may help firms mitigate the liability costs facing firms in foreign capital markets.

**HOME BIAS IN CAPITAL MARKETS**

A review of the literature on home bias suggests that there are at least four major types of costs that result in LOF in capital markets. These are
regulatory costs, information costs, unfamiliarity costs, and costs arising from cultural differences (Ahearne et al., 2004; Cai & Warnock, 2004; Chan et al., 2005; Daude & Fratzscher, 2007; Tesar & Werner, 1995).

However, despite a long and persistent history of empirical investigations, primarily in the finance area, we still do not have a robust explanation for this pervasive phenomenon of home bias in capital markets (Miller, 2009). Next, we discuss the various explanations for home bias and the resulting LOFs.

**Regulatory Costs**

Researchers suggest that when investors perceive that the costs of acquiring and holding foreign equities are higher than they are for domestic securities, investors will choose to keep their wealth at home. Costs stemming from formal institutional differences between home and host countries, such as foreign taxes, protections afforded to minority investors, and costs resulting from institutional barriers to trade assets, reduce the expected returns on foreign assets relative to domestic assets, and hence, the gains from diversifying abroad. Certainly, transaction costs, taxes, and other legal restrictions serve as a barrier to international investment, yet to date there is considerable disagreement over the extent to which formal institutional barriers account for the home equity bias (Tesar & Werner, 1995).

Despite the recent deregulation and liberalization of capital markets and the resulting lowering of formal institutional barriers, home bias continues to persist (Ahearne et al., 2004). Studies by French and Poterba (1991), Tesar and Werner (1994, 1995), Cooper and Kaplanis (1994), Lewis (1999), Coen (2001), and Glassman and Riddick (2001) demonstrate that empirical support for a cost-based explanation for home bias is generally poor. Instead, differences in legal frameworks concerning, for example, accounting systems, corporate governance, restrictive investment regulations, or investor protection persist and can likely explain at least part of the home bias (Oehler, Rummer, & Wendt, 2008; Chan et al., 2005; Dahlquist, Pinkowitz, Stulz, & Williamson, 2003; Rowland, 1999). Similar logic applies when local investors provide capital to overseas companies. Although in theory there is no difference between the characteristics of debt or equity issued by a foreign company locally, investors’ sentiments toward these financial instruments may be driven by regulatory differences and costs associated with the firm’s country of origin. In particular, differences in the
investor protection regimes may be translated into substantial LOF costs for companies coming from less “investor-friendly” countries.

**Information Costs**

Information asymmetry has become the most recent focus in the literature to explain home bias and patterns of transnational portfolio investments in general (Aviat & Coeurdacier, 2007; Daude & Fratzscher, 2007; Hooper & Kim, 2007; Portes, Rey, & Oh, 2001; Portes & Rey, 2005). Asymmetries exist because insiders (managers) are able to continually observe changes in investment productivity on an individual asset basis, while outsiders are only able to obtain highly aggregate information at discrete points of time (Aboody & Lev, 2000). In international financial markets, such an unequal distribution of information between national and foreign investors can result in home bias. Asymmetries can also stem from uncertainties regarding the codified rules regulating the behavior and activities of company insiders in foreign markets. In addition, information such as business practices and conventions, national cultures, and corporate cultures are required for investors to evaluate financial assets. As Kostova and Zaheer (1999) suggest, informal institutions based upon within-country norms represent the most difficult dimension for outsiders to learn, understand, and react to. Recent empirical studies suggest that information costs do indeed affect the composition of investors’ portfolios. For example, researchers have found that foreign equity portfolios are skewed toward the equities of large firms (Kang & Stulz, 1997). Also information flows are an important determinant of cross-border equity transactions (Portes & Rey, 2005). Finally, within countries, investors tend to favor investing in local companies (Coval & Moskowitz, 1999). Hence, not surprisingly, among both local and nonlocal investors asymmetric information is an important factor for investment decisions.

**Unfamiliarity Costs**

Along with information costs, research has shown that firms must also contend with the fact that investors do not invest in firms they are not familiar with. Merton (1987) shows that due to the high costs of information gathering and processing, investors only invest in a subset of eligible securities that they are familiar with. A focus on the known or the familiar is
sometimes referred to as a “habitat effect” (Barberis, Shleifer, & Wurgler, 2005). Extant empirical literature provides support for Merton’s argument in international setting, where investments by investors in foreign markets are typically allocated to large, less risky, and prominently visible firms (Dahlquist & Robertsson, 2001; Kang & Stulz, 1997). Familiarity can also have negative effects. For example, Chan et al. (2005) find strong support for irrational familiarity by revealing the overweighting of investment portfolios in investors’ home markets, and underdiversifying the capital that is left for foreign investment across selected few “familiar” international markets.

Some investors might display a familiarity bias or local bias related to geographic proximity (Goetzmann & Kumar, 2004; Ivkovich & Weisbenner, 2005). Coval and Moskowitz (1999) show that a geographic proximity effect works even within US domestic stock portfolios. These authors demonstrate mutual fund managers prefer to invest in firms headquartered close to their home cities. Similarly, Fellner and Maciejovsky (2003) describe that investment biases can be regional, rather than national in nature. Morse and Shive (2003) find that portfolio allocation by US investors reflects “patriotism,” that is, a preference for domestic securities. Hence, they will be particularly apprehensive with regard to buying securities issued by foreign firms due to their lack of familiarity, thus contributing to LOF costs.

Kang and Stulz (1997) show that foreign investors in Japan prefer large, international manufacturing firms. In a recent study of a large number of international funds with holdings in 11 developed countries, Covrig, Lau, and Ng (2006) investigated stock selection by domestic and foreign fund managers and found that domestic managers typically prefer smaller, high market-to-book firms. On the other hand, Cai and Warnock (2004) analyze foreign and domestic institutions’ positions in US securities and find that both foreigners and domestic investors prefer large, internationally diversified firms. Therefore, foreign companies that do not fall under these categories may face additional costs of raising capital on a local capital market, hence increasing its LOF costs.

Familiarity with foreign markets on the part of managers plays a role in their decision on whether to seek capital resources abroad or where to seek it. For example, Sarkissian and Schill (2004) find that geographic proximity of the foreign market plays a dominant role in selecting overseas listing destinations. In addition, the international experience of top management teams, international scope of operations, and industry have all been shown to be factors which prompt firms to seek equity resources outside their local capital markets (Bell, Moore, & Al-Shammari, 2008; Blass & Yafeh, 2001;
Hursti & Maula, 2007). This suggests that internationalization increases the firm’s visibility and decreases investors’ unfamiliarity costs.

**Cultural Differences**

It is quite conceivable that cultural differences between countries are likely to influence a wide range of capital market transactions (Guiso, Sapienza, & Zingales, 2006). Indeed, these differences can affect the level of trust and nature of financial contracting (Guiso, Sapienza, & Zingales, 2008). The effect of culture in economic outcomes has been a topic in many recent studies in the field of financial economics. However, much of the focus of this stream of research has been to explain variations in institutions or legal practices, rather than individual investor behavior.

In one of the first studies examining the importance of culture and investment behavior, Grinblatt and Keloharju (2000) revealed that investors are more likely to hold, buy, and sell the stocks of firms that are located close to the investor, that communicate in the investor’s native tongue, and that have chief executives of the same cultural background. Subsequent studies have supported these findings. Morse and Shive (2003) show that cultures with high levels of patriotism have a larger proportion of their investments allocated at home, with Chui, Titman, and Wei (2009) proposing that cross-cultural differences in terms of individualism versus collectivism are related to trading activity levels and security pricing across countries. Chan et al. (2005) find that portfolio allocations of mutual funds depend upon both cultural and economic familiarity. However, these two factors also have significant but asymmetric effects on the foreign bias. When a host country is more remote from the rest of the world and has a different language, domestic investors will invest more in that country’s market, while foreign investors will invest less. On the other hand, when a host market is more developed, larger in market capitalization, and has lower transaction costs, foreign investors will invest more and domestic investors will invest less in the market (Chan et al., 2005). Finally, in their recent papers, Guiso et al.(2006, 2008) show that perceptions rooted in culture are important and generally omitted determinants of economic exchange. For example, they find that level of trust is related to amount of trade, portfolio investment, and direct investment. This growing body of literature points to an assumption that cultural issues and trust may be antecedents of LOF costs even in financial markets.
STRATEGIES FOR OVERCOMING LOF IN CAPITAL MARKETS

The existence of liabilities stemming from foreignness makes it an imperative for firms accessing international capital markets to engage in strategies designed to overcome these liabilities. Although the problems of information asymmetry can be addressed to some extent with greater frequency and quality of disclosure, and problems arising from unfamiliarity may diminish over time, one of the fundamental problems faced by foreign firms in international capital markets is what Schmidt and Sofka (2009) referred to as “legitimacy deficit.” Underlying the issues of regulatory costs and cultural differences that we discussed earlier is the more fundamental problem of legitimacy deficit. Legitimacy refers to “a generalized perception or assumption that the actions of an entity are desirable, proper, or desirable within some socially constructed system of norms and values, beliefs and definitions” (Suchman, 1995, p. 574). Thus, foreign firms have to engage in actions that increase their legitimacy in foreign capital markets. Increasingly researchers are looking at ways that enable firms to overcome investor biases. In the ensuing sections, we summarize these legitimation strategies identified in prior literature, and highlight how bonding, signaling, and isomorphic business practices may be potent strategies that firms can employ to mitigate LOF in international capital markets (Fig. 3).

**Bonding**

In his extensive review Karolyi (2006) suggests that firms may choose to cross-list their shares on overseas markets as a means to improve a firm’s
corporate governance systems. Under the bonding hypothesis, a listing in a developed capital market, such as New York or London, provides a means for foreign issuers to credibly commit to stricter regulation and the protection of investor rights against managerial self-dealing or excess consumption of private benefits of control. In other words, foreign firms that list on US exchanges “bond” themselves to the US regulatory regime, where investor protections are high. By committing themselves to stricter regulation, the firms can lower their cost of capital and enjoy greater access to capital markets. This occurs because, as Coffee (1999) argues, exposure to SEC enforcement and shareholder litigation decreases the principal-agency problem. Once foreign issuers list in capital markets that have stricter governance regulations than their own home market, the relative importance of variations between the corporate laws and corporate governance of different countries should decline in the minds of potential investors. Studies have found that firms from countries with poor investor protection experience increase in market value from a US listing (Doidge, 2004). Consequently, research has shown that in addition to seeking larger market capitalization, greater liquidity, higher valuations, performance, and foreign sales, legal bonding is part of the international capital-raising decision for a growing percentage of foreign firms (Claessens, Klingebiel, & Schmukler, 2003).

**Signaling**

Signaling theory refers to methods investors use in situations of information asymmetry where insiders (e.g., owners) of an IPO hold more information than outsiders (Spence, 1973). IPOs are characterized by information asymmetry in which owners have more complete information than investors regarding the quality of the firm (Beatty, 1989; Carter & Manaster, 1990). As a result, scholars have focused on uncovering a range of signals associated with the IPO firm that managers employ to convey its value to potential investors (Certo, Daily, & Dalton, 2001; Filatotchev & Bishop, 2002; Sanders & Boivie, 2004; Zahra & Filatotchev, 2004). Some of these signals may be aimed at reducing LOF.

A McKinsey survey of more than 200 institutional investors who hold accounts worldwide revealed that their decision to invest is largely determined by the governance of a firm (Coombes & Watson, 2000). Hence, it is not surprising that, apart from a range of firm-level demographic characteristics such as age, size, industry affiliation, etc., corporate
governance characteristics, such as retained share ownership (Loughran & Ritter, 2004), and board characteristics (Arthurs, Hoskisson, Busenitz, & Johnson, 2008), can also impact on IPO performance. In the USA, research has found that independent directors impact a range of board decisions, including the removal of nonperforming CEOs (Weisbach, 1988) and resisting greenmail payments (Kosnik, 1987). Boards with higher proportions of outside directors have lower incidences of financial statement fraud (Beasley, 1996), while boards dominated by management are more likely to incur accounting enforcement actions by the SEC (Dechow, Sloan, & Sweeney, 1996). Evidence from the UK has shown that firms with a majority of outside directors exhibit greater reporting conservatism (Beekes, Pope, & Young, 2004). In addition, numerous studies in the field of accounting demonstrate that firms with independent directors engage in less-earning management (Chtourou, Bedard, & Courteau, 2001; Peasnell, Pope, & Young, 2000; Xie, Davidson, & Dadalt, 2001). In sum, strengthening internal governance can indicate to outsiders the willingness of managers to adhere to heightened governance standards.

This is particularly relevant for firms attempting to enter an overseas capital market. As we discussed above, this scenario is associated with high information asymmetries that may be translated into higher LOF costs. By signaling its value through “good corporate governance,” the firm may differentiate itself from other firms from the same country (Filatotchev & Bishop, 2002), and, therefore, reduce costs associated with LOF.

**Isomorphic Business Practices**

Firms often adopt practices of those organizations that appear to be successful based on the salient properties they perceive through market interactions and the prevailing institutional logics considered legitimate by the institutional environment (Zajac & Westphal, 2004). Institutions constrain firm behavior by communicating “rules of the game” and what is considered legitimate (Meyer & Rowan, 1977; DiMaggio & Powell, 1983). Suchman (1995, p. 574) argues that legitimacy is “possessed objectively, yet created subjectively,” suggesting that legitimacy is a socially conferred status resulting from evaluations by other stakeholder groups. Those firms considered legitimate by market stakeholders tend to succeed more frequently in competitive capital markets (Deeds, 2004). In fact, legitimacy is considered especially important to emerging firms entering a market because the organization’s chance of survival is significantly enhanced (Aldrich & Fiol,
increased legitimacy has been associated with generating increased resource flows for the foreign firm (Deeds, 2004; Meyer & Rowan, 1977).

Legitimacy is a primary outcome of institutional isomorphism, defined as the resemblance of a focal organization to other organizations in its environment (DiMaggio & Powell, 1983). For example, having a founder-CEO may present an advantage to foreign firms seeking capital in the UK. Previous studies indicate that public market investors in the UK are more tolerant with regard to founder control over listed firms. For example, Filatotchev (2006) indicates that in the majority of newly listed firms founders continue to lead the firm either as a CEO or as a chairman with the average founder ownership amounting to 26.4 percent. On the other hand, firms that offer incentives to compensate executives may be looked upon more favorably by outsiders. For example, studies based on US IPOs demonstrate that US investors look favorably upon IPO firms that offer options to their executives (Certo, Daily, Cannella, & Dalton, 2003; Sanders & Boivie, 2004) because it has achieved “taken-for-granted status” (Sanders & Boivie, 2004, p. 171) among financial and business community members in the United States. Finally, research has shown that internal organizational practices can reduce investor biases. For example Bradshaw, Bushee, and Miller (2004) found that US investment in foreign firms does in fact increase when these firms opt to rely on US GAAP. Thus, foreign firms that adhere to local perceptions and standards in terms of their organizational design, corporate governance and management style may obtain a higher level of local legitimacy. As a result, this enhanced legitimization may lead to a reduction of its LOF.

Certifications and Endorsements

As Rao (1994) notes “the very act of endorsement embeds an organization in a status hierarchy and thereby builds the reputation of an organization” (p. 31). Therefore, a relationship with a high-status partner can be considered a powerful endorsement for the unfamiliar firm and thus act as a reputational source of legitimacy (Baum & Oliver, 1991; Podolny, 1994). Coffee (1999, 2002) and Stulz (1999) emphasize the role of “reputational intermediaries” in US markets, such as underwriters (in the case of capital-raising listings), auditors, debt-rating agencies, securities analysts, as well as the exchanges themselves (via listing requirements), in providing additional scrutiny or monitoring that is unavailable in the home market. Similarly, research has shown that the presence of local investors with whom VC firms
can partner in a syndicate may play an important role in taking on certain responsibilities that may be easier to manage from a domestic position (Makela & Maula, 2005). These local investors are attractive to foreign investors, because they have information about the operation of the local market, including access to deal flow, as well as dense networks of contacts and familiarity with different legal requirements.

Studies have also demonstrated the value of third party endorsements (e.g., prestigious underwriters, audit firms, and alliance partners) in light of the degree of uncertainty surrounding security issues, such as an IPO (Gulati & Higgins, 2003). Some researchers have looked at a wide assortment of organizational and extraorganizational attributes that serve as important cues regarding the quality of a firm at IPO and lessen the likelihood managers would need to reduce the offer price in order to attract investors (Ritter, 1991; Ritter & Welch, 2002). For example, the role of the well-established and recognized underwriters to the success of IPOs has been highlighted in a large number of studies (Booth & Smith, 1986; Carter, Dark, & Singh, 1998; Carter & Manaster, 1990; Hansen & Torregrosa, 1992; Jain & Kini, 1999; Loughran & Ritter, 2004). They are relevant social actors and can confer legitimacy to IPOs, but their power to do so may vary between the USA and other capital markets. For instance, in the UK, investors evaluating AIM-listed firms rely on the standing of nomads as a proxy for the quality of listed companies (Davidoff, 2007). The vast majority of nomads are lower and medium-tier investment banks who maintain a network of exclusive clients mostly within the City of London such as investment funds and individual investors. Rules regulating nomads are much more relaxed compared to the US rules surrounding the practices of investment banks, and the whole industry is mainly driven by informal networks and reputational concerns (Davidoff, 2007).

Here nomads serve as gatekeepers, advisers, and regulators of AIM-listed companies (The Combined Code, 2006). These firms also perform an ongoing post-listing role to ensure the transparency of the listed firms’ operations, and ensure market awareness “of all information that needs to be in the public domain,” to determine which information merits disclosure (Aaronson, 2007, p. 29).

**MANIFESTATIONS OF LOF IN CAPITAL MARKETS**

Any serious empirical investigation of LOF in capital markets is not possible without some reliable ways to operationalize and measure such liabilities. The conventional approach to measuring liabilities of age and size
has involved an examination of the survival or profitability rates of firms. Although several studies of LOF in the context of product markets have examined strategies for overcoming these liabilities, most of them have taken its existence for granted. In recent years, however, there have been more rigorous efforts to empirically establish that indeed there are actual specific costs to being foreign. Zaheer (1995) demonstrated that there are systematic differences in the profitability of foreign trading rooms compared to local trading rooms in the same location, and attributed the lower profitability of foreign trading rooms to LOF. Zaheer and Mosakowski (1997) found that foreign trading rooms have a lower chance of survival compared with local trading rooms providing additional empirical demonstration of the existence of LOF. Hennart, Roehl, and Zeng (2002) advise caution in using survival or exit rates as a proxy for LOF because exits can be due to a number of other reasons as well. They also argue that exits and profitability may be imperfectly correlated. According to Hennart et al. (2002) and Mezias (2002), even profitability differences between local and foreign firms can only provide a weak measure of LOF because profitability numbers suffer from aggregation problems. That is, they aggregate both the costs arising out of LOF with profits arising out of firm specific advantages. Several papers have made efforts to separate out specific costs that result from LOF. Mezias (2002), for example, studied the differences in labor lawsuit judgments affecting foreign and local firms in the USA. Similarly, Miller and Parkhe (2002) examined differences in X-efficiency between US-owned and foreign-owned banks in the global banking industry. Schmidt and Sofka (2009) examined differences in host country knowledge spillovers between foreign subsidiaries and domestic firms in Germany. Each of these studies represent efforts to tease out specific costs of LOF rather than the earlier aggregate approach of examining differences in profitability and survival rates.

Identifying and measuring LOF in capital markets present challenges that are specific to capital markets. For example, there is no equivalent of profitability in capital markets, whether debt or equity markets. In the case of foreign IPOs and cross-listings, the foreign firm’s cost of capital compared to domestic firms may provide a benchmark for LOF. For example, the extent of underpricing, or difference between an offer price and actual trading price of securities, relative to domestic firms after controlling for other firm-specific and industry-specific factors, could be a promising measure. Similarly, differences in analyst coverage, trading volume, and investor lawsuits could provide some indication of LOF. Other differences that could be attributed to LOF include differences in underwriting fees,
if any, and differences in the quality and prestige of underwriters and auditors backing firms seeking equity resources in foreign capital markets. Despite the caution suggested by Hennart et al. (2002) in attributing exits to LOF, we suggest that another promising way to measure LOF would be to identify delisting decisions. Table 1 reveals there is considerable variance in the delisting activities of firms who choose to list outside their home market. Hence, it is important to investigate the underlying sources of delisting activity of foreign firms within capital markets and to evaluate how they compare across institutional contexts. Finally, Brau and Fawcett (2006) recently surveyed US CFOs regarding their perceptions of the US IPO process and the critical ingredients that enable firms to achieve high performance. Similar queries could also be made of CFOs outside the US institutional context. While it is premature to converge on a single indicator of LOF in equity markets, the careful examination of many of the indicators suggested above can potentially provide valuable insights into the existence of LOF and its magnitude.

**DISCUSSION AND DIRECTIONS FOR FUTURE RESEARCH**

LOF has been one of the most researched topics in international business since the beginning of the field in the early 1960s. LOF is central to the development of theories of the firm, but most such theories accorded LOF what amounts to a “taken-for-granted” status. Starting with the pioneering work of Zaheer (1995), the last 15 years have seen a sudden proliferation of empirical and theoretical work on LOF and many stimulating intellectual debates on the domain of the construct, its measurement, and strategies for overcoming it. It was natural that much of this work focused on LOF in product markets because much of the early internationalization efforts of firms in developed and emerging markets occurred primarily in product markets. However, internationalization of capital markets is a relatively recent phenomenon. As firms rush to cross-list their stock in multiple markets, choose to make their capital market debut in foreign markets through IPOs, make seasoned equity offers, access debt markets outside their geographical boundaries and even seek venture capital from VC outside their home markets firms, it becomes topical and relevant to examine if LOF exists in capital markets and if so, what strategies can be pursued to overcome it. This paper represents an initial effort to identify the
sources of LOF in capital markets and propose strategies for erasing the legitimacy deficit suffered by foreign firms in international capital markets. We believe that such an effort is important for the theoretical development of the field of international business. Needless to say, it is also extremely important for practicing managers in an era of global competition for resources and markets.

Institutional theory has become an increasingly prominent theory that offers a more contextualized understanding of economic phenomena and firm strategic behavior (Peng, Wang, & Yi, 2008). Certainly firms can experience liabilities in capital markets stemming from the institutional environment of their country of origin. However, the institutional environment in which firms choose to source foreign capital is also critical to their success. As such, institutions offer especially important insights into market activity and market performance, as they function to reduce uncertainty for market actors by defining what is considered legitimate in a particular market context (North, 1990; Scott, 2008).

Scholars have posited that capital markets are only boundedly rational, and as a result, a range of organizational factors, such as corporate governance practices, may be embedded in social, organizational, and historical contexts that differ significantly from the purely rational approach suggested by traditional agency theory (Westphal & Zajac, 1994, 1998; Zajac & Westphal, 1995, 1996, 2004). As we highlighted earlier, evaluations of the strategies firms employed to mitigate the costs associated with LOF, especially of those signals IPO firms use to overcome information asymmetry and associated agency conflicts (Certo, 2003; Certo et al., 2001b), have largely ignored differences in institutional settings. Indeed, the overwhelming majority of studies examining the capital-seeking strategies of firms have been conducted in singular institutional settings. This is surprising given the growing number of studies that combine agency research with institutional theory to show that differences in national institutions can impact the nature and extent of agency conflicts at a firm level, as well as the effectiveness of corporate governance remedies that are supposed to mitigate these conflicts (Aguilera, Filatotchev, Gospel, & Jackson, 2008; Bruton, Filatotchev, Chahine, & Wright, 2010; Bruton, Chahine, & Filatotchev, 2009). Or as North (1990, p. 92) notes, differences in the “evolution of societies, polities, or economies over time” are attributed to disparate levels of knowledge between market actors.

While it is critical to understand the sources of LOF costs that firms experience in foreign capital markets, it is also important to understand how LOF costs can vary across capital markets. Considerable research attention
has been devoted to examining the differences between the institutional environments of emerging and developed economies (Wright, Filatotchev, Hoskisson, & Peng, 2005). However, it is equally important to uncover differences in the formal and informal dimensions of capital markets in developed economies. Although “law and economics” research presents a first attempt to differentiate between national institutional environments by focusing on the country’s legal origin (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1997, 1998), this research still deals with highly aggregated proxies for institutional differences, and pools together in a single group countries with quite different institutional characteristics. In this paper, we suggest that more fine-grained analysis is needed to uncover costs and remedies of LOF. For example, the US and UK capital markets have different sources of institutional isomorphism and consequently operate under different institutional rationales. In formal, regulative environments (e.g., USA), coercive mechanisms are used for institutional diffusion and include legal procedures and official sanction to enforce compliance through hierarchically structured authority systems. Conversely, informal normative environments (e.g., UK) rely on relational structures such as professional networks, interlocking directorates, informal ties, or normative standards explicitly established through representative bodies (Scott, 2008, pp. 134–136). As a result, foreign firms opting for raising capital in the two markets should deploy different strategies if they want to mitigate their LOF.

Recent research in entrepreneurship has begun to investigate the strategic choice facing IPOs regarding the choice of listing at home versus foreign capital markets utilizing a host of organizational and governance factors. For example, Ding, Nowak, and Zhang (2010) examined Chinese firms and their choice of listing in Hong Kong (i.e., foreign listing) versus at home (Shenzhen). Similarly, international experience of the IPO firm’s management team and retained ownership levels have been shown to predict foreign market choice rather than listing on the firm’s domestic exchange for European IPOs (Hursti & Maula, 2007). However, given the expanding opportunities available to firms to source capital abroad, what is conspicuously missing is an investigation of the institutional and firm-level factors that influence the choice between foreign capital markets and the extent to which such choice is influenced by managerial perceptions of the magnitude of LOF they will encounter in different capital markets.

Early studies by Saudagaran (1988) and Biddle and Saudagaran (1989) sought to understand the motivations for MNCs to offer their shares on multiple stock exchanges through international cross-listings. Since this
early work, many in the field of finance have focused on factors related to
cost of capital, valuations, disclosure costs, and liquidity to understand why
firms choose certain financial markets. However, a growing body of research
has explored how nonfinancial factors such as similar language, culture, and
geographical proximity impact the capital-raising activities of MNCs. For
example, Pagano, Roell, and Zechner (2002) emphasize the importance of
geography in listing choices. They show that during the period from 1986 to
1997, many European companies listed on US exchanges while the number
general support for many of the established factors, such as disclosure costs,
liquidity, and cost of capital; however, they highlight proximity preference
as a surprisingly important factor, especially for non-G-5 (France,
Germany, Japan, UK, and USA) countries. In a follow-up study, Sarkissian
and Schill (2005) suggest that information and investor familiarity can
greatly impact cross-listing decisions.

In addition to large multinationals, the home bias phenomenon extends to
a wide array of organizations seeking capital resources, including the
economic activities of venture capital and private equity firms. For example,
cultural differences and geographical distance can create problems in
cross-border VC investments and can diminish the commitment of venture
capitalists in foreign markets (Makela & Maula, 2005). Cumming and Johan
(2006) argue that “home bias” is particularly acute for private equity
investors. They contend that during the screening and selection phase it is
less costly to screen close than distant companies. Second, during the
investment phase, physical proximity makes information flow, monitoring,
and value-adding activities easier (see also Lerner, 1995; Sorenson & Stuart,
2001). Finally, proximity facilitates exiting (see also Jääskeläinen & Maula,
2005). For example, home bias can limit the use of foreign stock exchanges
as exit markets for entrepreneurs (Hursti & Maula, 2007). The accumulation
of a number of empirical studies on home bias in the finance literature
can provide researchers in international business with many valuable
insights on the causes and extent of LOF in capital markets. We believe that
the study of LOF in capital markets can be advanced through inter-
disciplinary collaboration between researchers in the areas of international
business and finance.

Finally, much of our discussion in this paper was restricted to LOF in
equity markets and we drew from the literature on cross-listings and foreign
IPOs to suggest strategies for overcoming LOF. Equity markets are only
one component of capital markets. The emergence of international VC firms
has greatly expanded opportunities for start-up firms to access capital.
Firms are increasingly accessing foreign banks as well as international bond markets to access debt capital. The expansion of the domain of the LOF construct to capital markets requires the examination of its prevalence in debt markets as well as equity markets.

**CONCLUSION**

In this paper, we argue for the expansion of the domain of the LOF's construct to include liabilities faced in capital markets. The increasingly integrated global capital has greatly impacted on the opportunities available to firms worldwide seeking to lower their costs of capital. However, a significant body of literature has demonstrated a pervasive bias among investors against firms founded in dissimilar cultural and institutional environments. Indeed, overcoming investor bias represents real costs to the firm and is a steep challenge to the manager looking to acquire capital resources abroad. In this paper, we identify a number of causes for investor bias and the resulting LOF, and suggest a range of strategic responses that firms can employ to overcome them.

**REFERENCES**


Liability of Foreignness: New Insights from Capital Markets


INSTITUTIONAL DISTANCE IN INTERNATIONAL BUSINESS RESEARCH

Jin-Hyun Bae and Robert Salomon

ABSTRACT

Understanding institutional distance – i.e., the difference in institutional context between countries – is critical for firms whose operations span national boundaries. Institutional distance impacts the relative attractiveness of country markets, trade-offs among foreign market entry strategies, the management of subsidiaries abroad, and ultimately, firm performance. Although scholars in various disciplines have made great advances in defining and measuring the institutional characteristics of nations, we contend that many of these advances have occurred in a parallel fashion. Moreover, extant empirical studies focus disproportionately on the impact of different subsets of the identified institutional characteristics. We suggest that it is time to find common ground across the disparate literatures. Doing so would allow us to view differences in institutional contexts more holistically, and refine our understanding of their implications for multinational corporations.
International business research has shown that foreign firms often operate at a disadvantage compared to domestic incumbents (e.g., Zaheer, 1995). This “liability of foreignness” (Hymer, 1960) stems from a relative lack of knowledge of the local environment, its practices, its customs, and its regulations. The liability of foreignness often manifests as an increase in various costs – e.g., coordination, transaction, knowledge transfer, labor, legal (Hennart, 1982; Johanson & Vahlne, 1977; Lipsey, 1994; Mezias, 2002; Mincer & Higuchi, 1988; Salomon & Martin, 2008; Zaheer, 1995). Moreover, performance difficulties foreign subsidiaries face as a result of the liability of foreignness are well documented (Zaheer, 1995; Zaheer & Mosakowski, 1997).

At the root of the liability of foreignness lie differences in institutions across countries (Ghemawat, 2001; Hymer, 1960; Kostova & Zaheer, 1999; Perkins, 2009). It is therefore hardly surprising that international business scholars are interested in institutional distance, i.e., the extent of similarity or dissimilarity between the institutional environment of any two countries (Gaur & Lu, 2007). By institutions, we refer to North’s definition as “humanly devised constraints that structure political, economic, and social interaction … [and that] provide the incentive structure of an economy …” (1991, p. 97). This suggests that when considering institutions and institutional distance, both formal and informal factors ought to be considered (Scott, 1995/2001). Formal factors include regulatory, political, and economic institutions, while informal factors refer to social norms, beliefs, values, and widely shared knowledge or cognitive categories.

Not surprisingly, institutional distance has been found to impact key international business decisions such as foreign market entry, country selection, entry mode, and performance (e.g., Kogut & Singh, 1988; Kostova & Zaheer, 1999). Table 1 reviews the areas of inquiry to which institutional distance has been applied.

Although there has been considerable research on both the antecedents and consequences of institutional distance, the majority of studies relating to institutional distance focus on only one subset of institutional factors at a time (e.g., Kogut & Singh, 1988; Benito & Gripsrud, 1992; Brouthers & Brouthers, 2001), with different literatures emphasizing different factors. Moreover, although the international management, strategy, organization theory, and economics literatures have made great progress in defining and measuring the institutional characteristics of nations, many of these advances have occurred in a parallel fashion. It is time to find common
ground among the disparate conceptualizations of institutional environments, and its related empirical measure, institutional distance.

We begin by looking at the various dimensions used in the conceptualization and operationalization of institutional distance. Then we address what gaps remain, to highlight the importance of coming up with a broader, more comprehensive institutional distance measure, and a unified approach to its measurement.

**DIMENSIONS OF INSTITUTIONAL DISTANCE**

The dimensions of institutional distance that have been studied can be broadly categorized as political, regulatory, economic, cultural, and cognitive. Empirically, the measurement of institutional distance has involved first estimating the strength of the host and home countries’ institutions along one or more of these dimensions to create institutional profiles, and then calculating a “difference” between them.¹

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¹Brouthers and Hennart (2007) review the literature on international entry modes.

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<th>Table 1. Institutional Distance and Areas of Study.</th>
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¹Brouthers and Hennart (2007) review the literature on international entry modes.
Although scholars across disciplines define institutions broadly, they hold differing views on which dimensions are the primary drivers of institutions and cross-country differences. Depending on the underlying discipline, scholars have tended to use some subset of preferred dimensions to operationalize institutional distance. To illustrate, international economics researchers have been interested in differences in formal institutions (Williamson, 2000), although they do acknowledge the cognitive implications of institutions (Dequech, 2002; Hodgson, 2007). By contrast, those taking a more sociological viewpoint favor the regulative, normative, and cognitive components of institutions. Their viewpoint puts a greater weighting on informal factors.

Starting with formal dimensions, political distance refers to differences in governmental and political institutions (e.g., Perkins, 2009). Political institutions can be important as they may reduce transaction costs by improving the security of property rights and contract enforcement (North, 1997). However, governments can equally be ineffective in these tasks and, in some cases may even be the primary threat to the enforcement of property rights and contracts. It is important for firms to understand the political environment in which they operate, and how it is likely to change if they are to anticipate how transaction costs might change. The greater the political distance foreign firms face, the more difficult it becomes for them to anticipate changes in the host country and to operate effectively (e.g., Martin, Salomon, & Wu, in press; Gaur & Lu, 2007).

Political distance measures most often used in the international business literature emphasize the effectiveness of political institutions and the uncertainty of the political environment. For example, the political constraints (POLCON) index (Henisz, 2002) measures a country’s political risk by assessing the likelihood of an unfavorable change in the governmental regime or in the policies enacted by the existing regime (Henisz, 2000; Miller, 1992). POLCON uses the number of independent veto points over policy outcomes and the preference distribution of actors within the system. These veto players are presumed to act as constraints on politicians’ behavior and encourage policy stability and predictability.

Another popular measure, the CHECKS index, also takes into account the number of veto players in a system (Beck, Clarke, Groff, Keefer, & Walsh, 2001; Keefer & Stasavage, 2003). The influence of these veto players is then adjusted for independence, which is affected by the level of electoral competitiveness, party affiliations, and the electoral rules. This adjustment helps distinguish the effectiveness of electoral checks on government decision makers across countries, as well as account for the control that political parties wield.
A third measure is from Kaufmann, Kraay, and Mastruzzi (2007), who measure six features of political institutions: voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. Beyond the stability of governments, governmental policies, and the effectiveness of checks and balances, the Kaufmann et al. (2007) metric captures the extent to which the government and the country’s citizens respect extant legal and political institutions.

Finally, the La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998) classification of legal origin has been used to proxy for political or legal system similarities or differences. However, their metric was specifically developed to examine corporate governance regimes across countries rather than political or legal differences per se. That notwithstanding, we acknowledge that it is important to consider legal institutions (civil law, common law, etc.) as an element of the broader political and/or regulatory environment (Kaufmann et al., 2007; La Porta et al., 1998).

Regulatory distance measures cross-country differences in the enactment and the enforcement of regulations (Perkins, 2009). Regulation is an important factor in a number of industries, such as banking (Miller & Parkhe, 2002; Salomon & Wu, 2010), telecommunications (Perkins, 2005, 2009), and utilities (Zelner, Henisz, & Holburn, 2009). Understanding the specifics of regulations as well as their enactment and enforcement in the host environment is vital. Since regulations tend to be specific to particular industries, measures of regulatory distance are often best tailored to the industries under study (Miller & Parkhe, 2002; Perkins, 2005, 2009; Salomon & Wu, 2010).

Although there is little doubt that cross-country regulatory distance is important, there is debate as to whether it is truly conceptually distinct from political distance. This is in part due to the way that new institutionalists define and operationalize the regulatory (or regulative) pillar of institutions. The regulatory pillar is one of the three pillars of the new institutional framework (Scott, 1995/2001), and it lays out the rules for doing business, reflects the laws and regulations of a region or country and the extent to which these rules are monitored and enforced. It is the only part of the framework that speaks to formal institutions. When the context calls for the inclusion of political institution differences, for those that adopt a new institutionalist approach, these are included in the regulatory distance measure. For example, Gaur and Lu (2007) and Xu, Pan, and Beamish (2004) use the 19 items classified under “institutions” in the Global Competitiveness Report to construct their regulatory distance measure. A number of these items, such as “public trust of politicians,” “diversion of
public funds,” and “transparency of government policy making,” could speak to the influence that political institutions have and the political risk that firms face.

The inclusion of a separate regulatory distance dimension may not be problematic, unless the enactment and enforcement of property rights, contracts, regulations, and the stability of laws, policies, and regulations are determined by the formal political institutions set in place. If this is the case, then there may be a high degree of interdependency and alignment between political and regulatory institutions, such that their relationship may be codetermined. If so, including both political and regulatory dimensions may be redundant. However, political institutions and regulatory enforcement need not be aligned, and their relationship may vary across countries. This suggests that, at the very least, political distance and regulatory distance ought to be considered separately for now, but their relationship remains an open issue.

Economic distance considers cross-country differences in patterns of exchange, economic structure, market orientation, and market stability (Ghemawat, 2001; Miller & Parkhe, 2002). This dimension has not received as much attention as the others, perhaps because it is not a key factor identified in institutional economics or new institutionalism. However, it has held greater relevance for macroeconomists in international trade. For example, gravity models in international economics show that countries transact more with similar others. Two geographically defined entities (e.g., countries, trading blocs) will have greater economic interaction (e.g., trade and investment) if they are closer in economic size, distance, and share historical links (Combes, 2008; Krugman & Obstfeld, 2006).2 Similarity in economic institutions encourages economic exchange.

Still, economic distance does matter at a more micro-level and this has been shown in the international business literature. For example, Miller and Parkhe (2002) demonstrated that foreign banks may operate less efficiently when their home country’s financial market orientation (whether financing is more reliant on external capital markets or banks) is very different from that of the host country. Similarly, Martin et al. (in press) discovered that firms are more likely to agglomerate in economically risky countries – those with greater volatility in GDP growth. Nachum, Zaheer, and Gross (2008) found that geographic proximity, weighted by economic development (investment, education levels, and the availability of resources), positively affects MNE location choice.

Despite these findings, economic distance has received less attention since patterns of exchange, economic structure, and so on may be viewed as the
result of firms and markets reacting to political, regulatory, and cultural institutions. Alternatively, one might argue that the causality runs in the reverse direction, with the way that the markets work affecting political and regulatory institutions directly and cultural institutions indirectly. Irrespective of causality (and both of these arguments may be equally valid), these points suggest that economic distance may be reflected in measures of other dimensions.

Turning to informal dimensions, cultural distance compares countries based on their cultural profiles (e.g., Benito & Gripsrud, 1992; Hofstede, 2001; Kogut & Singh, 1988; Li & Guisinger, 1991).³ Culture consists of beliefs, values, and norms (Scott, 1995/2001). Values define what is desirable, while norms define how things should be done. These normalize the behavior of organizational actors within societies (North, 1991; Scott, 1995/2001; Hofstede, 2001). National culture has been shown to impact managerial goals, management processes, organizational values, and organizational action (Hofstede, 1994). Cultural distance can lead to difficulties in communication and coordination between the parent and the foreign subsidiary, reducing operational effectiveness. It can also make the local market more difficult to understand and thus to penetrate successfully.

The operationalization of national culture in the international management literature was pioneered by Hofstede (1980), who suggests that differences can be described along five cultural dimensions: power distance, uncertainty avoidance, individualism-collectivism, masculinity-femininity, and long-term orientation. Power distance refers to the extent that people believe and accept unequal distribution of power and status.⁴ Uncertainty avoidance points to the extent to which people are uncomfortable with uncertain, unknown, or unstructured situations. Individualism and its polar opposite, collectivism, refer to the degree to which the role of the individual (relative to the group) is emphasized. Masculinity and feminism refers to the extent that traditional masculine values, such as competitiveness and assertiveness, or the extent that feminine ones, such as nurturing and minding the quality of life, are emphasized. A number of studies have used differences across these dimensions to measure cultural distance (see Kogut & Singh, 1988; Tihanyi, Griffith, & Russell, 2005).

Another prominent proxy for national culture was created by Schwartz (1994). Unlike Hofstede, Schwartz created concepts that are applicable to both individual and national levels of analyses. He derived three bipolar cultural value dimensions that relate to the ideal individual–group relationship, the ideal way to elicit productive activity, and the ideal way to regulate resource use. Analyzing the bipolar dimensions, he derived seven
types of values on which cultures can be compared: conservatism, intellectual autonomy, affective autonomy, hierarchy, egalitarian commitment, mastery, and harmony. Conservatism represents the emphasis on maintaining the traditional order.\(^5\) Intellectual and affective autonomy, respectively, refer to the extent that people are free to pursue their own ideas and their affective desires. Hierarchy refers to the extent to which unequal distribution of power, roles, and resources is tolerated, while egalitarian commitment denotes the extent to which people are willing to put aside self-interest for the welfare of others. Mastery refers to the importance of getting ahead by being assertive, while harmony refers to the importance of fitting in with the environment (Schwartz, 1999).

Although some view Schwartz’s framework as superior, conceptually more exhaustive, and meaningful (e.g., Brett & Okumura, 1998), and many have critiqued Hofstede’s framework (see Shenkar, 2001; Harzing, 2003), the more widely adopted measure of national cultural distance in international business is based on Hofstede’s work.\(^6\) For example, Kogut and Singh’s (1988) cultural distance index was constructed using four of Hofstede’s identified dimensions: power-distance, uncertainty avoidance, individualism-collectivism, masculinity-femininity. Some authors use a variation of the Kogut and Singh index – a Euclidean distance index (e.g., Barkema & Vermeulen, 1997; Brouthers & Brouthers, 2001), which does not attach equal importance to each of Hofstede’s dimensions and does not assume linearity and additivity. Nevertheless, the Kogut and Singh index is the most widely adopted measure in the international management literature (see Benito & Gripshrud, 1992; Li & Guisinger, 1991) despite the fact that it has failed to yield consistent empirical evidence when applied to questions on critical phenomena such as foreign direct investment (FDI) and entry (Shenkar, 2001).

Individual-level perceptual measures have also been used to assess cultural differences. These may be more relevant than national-level measures because they capture perceptions of managers that drive decision making and behavior (Shenkar, 2001; Zhao, Luo, & Suh, 2004). Few studies, however, take this approach (e.g., Evans & Mavondo, 2002; Kim & Hwang, 1992). These are, therefore, cruder and less complete than the more macro-level measures described above, as often they consist of a single perceptual item.

Cognitive distance reflects the difference in cognitive structures embedded in society (Scott, 1995/2001). These structures comprise frames, routines, and scripts used by individuals in a society to judge and to assign meaning to a phenomenon and to solve problems (Markus & Zajonc, 1985). Cognitive structures held by employees determine what information is retained and
how it is processed, organized and interpreted. Consequently, they reduce individual discretion and shape the routines developed in an organization. Cognitive distance has been a variable often included in studies that look at knowledge transfer across units or organizations. Measuring cognitive distance is a difficult task, and it requires measure development specific to the context and/or research question (e.g., Ionascu, Meyer, & Estrin, 2004).

In a way that seems parallel to the manner in which the sociology literature has collapsed political and legal/regulatory dimensions into a broader regulatory dimension, economists have tended to consider cognitive factors as subsumed by broader cultural factors. National culture and cognitive structures might be viewed by some as distinct theoretical constructs, especially since the former is operationalized using macro-level, nation-specific classifications provided by Hofstede and Schwartz, for example, and the latter is operationalized using more micro-level, context-specific measures. However, the line between the two may be blurred if the proxy for national culture is more issue specific. For example, a number of international economics studies explain cross-border trade and investment by using commonalities in language, religion, and history – wars or colonial ties – to proxy for culture and/or cultural distance (e.g., Anderson & Marcouiller, 2002; Barro & McCleary, 2003; De Groot, Linders, Rietveld, & Subramanian, 2004; Guiso, Sapienza, & Zingales, 2003, 2009; Linders, Slangen, de Groot, & Beugelsdijk, 2005; Srivastava & Green, 1986).

If the behavior of individuals, groups, and by extension, nations is guided by frames, routines, and scripts, then shared behavioral expectations and norms become part of a common collective identity (i.e., culture). This is so, irrespective of whether those norms evolve through shared language, religion, history, legal origin, or any other historical artifact. For this reason, we view the cultural and cognitive dimensions of institutions to be quasi-inseparable.

Table 2 lists a variety of studies that have operationalized institutional distance and its various dimensions in the ways in which we have just discussed. We identify the study, the specific dimension measured, and the measurement approach.

**UNRESOLVED QUESTIONS IN THE LITERATURE**

Although most papers that use institutional distance tend to focus solely on one aspect of distance, there are a few exceptions. Table 3 lists these studies, along with the dimensions they cover.
Table 2. Operationalization of Institutional Distance.

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Operationalization Based on</th>
<th>Representative Studies</th>
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<tr>
<td></td>
<td>POLCON index (Henisz, 2000)</td>
<td>Perkins (2009)</td>
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<td></td>
<td>CHECKS index (database of political institutions)</td>
<td>Salomon and Wu (2010)</td>
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<td></td>
<td>Custom survey item(s)</td>
<td>Evans and Mavondo (2002)$^a$</td>
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<tr>
<td>Regulative/legal</td>
<td>Legal origins (La Porta et al., 1998)</td>
<td>Perkins (2009)</td>
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<td></td>
<td>Country Risk Ratings (Euromoney)</td>
<td>Gaur et al. (2007)</td>
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<td></td>
<td>Regulatory factor of the Economic Freedom Index (The Heritage Foundation)</td>
<td>Ionascu et al. (2004)</td>
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<tr>
<td></td>
<td>Distance regarding banking activity, bank–commerce relations, competition, and capital regulations</td>
<td>Miller and Parkhe (2002), Salomon and Wu (2010)</td>
</tr>
<tr>
<td>Economic</td>
<td>Custom survey item(s)</td>
<td>Kim and Hwang (1992)$^c$, Evans and Mavondo (2002)$^d$</td>
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<tr>
<td></td>
<td>Volatility in GDP growth</td>
<td>Martin et al. (in press)</td>
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<td>Institutional Distance in International Business Research</td>
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<td>---------------------------------------------------------</td>
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<tr>
<td>Cultural/ normative distance</td>
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<tr>
<td>Clusters with dummy variables based on Ronen and Shenkar (1985)</td>
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<tr>
<td>Hofstede (1980)/Kogut and Singh (1988) index/ Euclidean distance index</td>
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<tr>
<td>Barkema et al. (1996), Chang and Rosenzweig (2001), Delios and Henisz (2000), and Gatignon and Anderson (1988)</td>
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<tr>
<td>Schwartz (1994) index</td>
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<tr>
<td>Custom survey item(s)</td>
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<td>Global Competitiveness Report</td>
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<td>World Values Survey</td>
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<tr>
<td>Cognitive</td>
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<tr>
<td>Custom survey item(s)</td>
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<tr>
<td>Combination of education level and cosmopolitanism items</td>
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<tr>
<td>Ionascu et al. (2004)</td>
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[a] Included in “business distance,” which includes political, economic, and regulatory dimensions.
[b] Focuses on rule-of-law tradition, legal development, judiciary system efficiency.
[c] Items that relate to demand and competition uncertainty are included in the “cultural distance” measure.
[d] He bundles legal/regulatory risk, cultural distance, and the stability of economic institutions together as “cultural context,” specifically “investment risk.”
[e] Uses managerial perceptions of national differences based on Hofstede’s five dimensions.
[f] Their cultural distance measure includes an aspect of political distance (transparency of government toward its citizens, from Country Risk Ratings).
[g] The study differentiates normative and cultural distance. Normative distance in this study may be considered cognitive distance in others, as they point to what constitutes usual management practices in a given country.
[h] Used to create clusters, not create a distance measure. Covers society wide general trust, civic norms of cooperation, associational intensity.
[i] Focusing on political transparency, fiscal policy, and bureaucratic corruption.
[j] For example, percentage workforce with tertiary education, number of computers/Internet hosts per 1000 persons.
To illustrate a few applications, Perkins (2005, 2009) in her studies of entry and survival in the Brazilian telecommunications industry considers political, regulatory, and cultural dimensions. Salomon and Wu (2010) study mimetic behavior of banks and include political, regulatory, economic, and cultural dimensions. Similarly, Martin et al. (in press) study agglomeration patterns in the semiconductor industry and focus on political, economic and cultural dimensions. A number of others consider regulatory, cognitive, and normative dimensions in work that look at staffing strategies (Gaur, Delios, & Singh, 2007), ownership strategies (Gaur & Lu, 2007), and the transfer of practices across units in different countries (Ionascu et al., 2004; Kostova, 1996).

Although these studies constitute a big step forward, it is not clear how the various sets of dimensions are selected. Moreover, there appears to be no clear standard measure, even when the studies are not issue specific, making comparison difficult. We believe that comparison difficulties are due, in large part, to the disciplinary perspectives adopted by scholars in this area. For example, studies drawing on an economic understanding of institutions, and institutional distance, generally adopt political, economic, legal, or regulatory measures of distance. Those that draw more on a sociological (new institutional) understanding of institutions, and institutional distance,
stress the regulatory, cognitive, and cultural components of distance. Irrespective of the disciplinary approach, many of the specific dimensions represent overlapping operationalizations of institutions, and consequently, institutional distance.

Adopting differing measures of institutions impedes progress in the broader literature because it limits discourse across literatures. It also encourages a proliferation of similar constructs. For instance, “institutional control” (Zhu & Tihanyi, 2008) is defined as the state’s attempt to regulate economic and social activities within the country. The instruments that the state has to achieve institutional control are regulatory, political, economic, and physical institutions. “Institutional quality” (e.g., Seyoum, 2009) and “institutional development” (e.g., Pattnaik & Choe, 2007) both involve a regulatory dimension. The former adds the political dimension, while the latter adds an economic dimension. Finally, one of the early conceptualizations of institutional distance in the international management literature – “psychic distance” (Johanson & Vahlne, 1977) – overlaps considerably with cultural distance, and has been operationalized using adjusted Hofstede indices (e.g., Nordstrom & Vahlne, 1992; Cuervo-Cazurra & Genc, 2009). However, as conceptualized, it was a much broader concept, including aspects of legal, political, economic, and even language differences.

Another factor that we believe has hampered the unification of the institutional distance construct revolves around limitations in our theoretical understanding of the construct itself. First, are some dimensions more important than others in an international business context, and does the relative importance of dimensions change across different decisions? For example, is regulatory distance more important than cultural distance when considering which country to enter into, but less so when choosing entry mode? Kostova and Zaheer (1999) find that when trying to establish and maintain legitimacy for local affiliates, normative and cognitive dimensions matter more than regulatory institutions, which are more formalized and arguably easier to understand. Second, might distance along one dimension be made up for by closeness along another? Alternatively, when might the dimensions be independent of one another? For example, knowledge transfer might be easier across units when employees in the units share similar national cultures, but be unaffected by political and/or economic distance. Third, how are the various dimensions of institutional distance codetermined, and how do they coevolve? For example, findings from a recent Inglehart and Baker (2000) study suggest that economic and political institutions evolve as cultures change. Taken together, these questions raise the issue of mechanisms that underlie the workings of institutional dimensions.
We need to think carefully not only about the theory justifying individual dimensions of institutional distance and advocating a joint distance construct, but also about what theory implies for the empirical measurement of institutional distance. Traditional measures of institutional distance (and its dimensions) consider the absolute difference in institutions between two countries. However, it is important to understand that there are some restricting assumptions in treating differences across institutions as absolute differences. Specifically, measures of distance using absolute differences assume that positive deviations across countries on any institutional dimension are equivalent to negative deviations on that dimension. This implies that distance imposes costs irrespective of the direction of that distance. However, it could be that distance in one direction might be easier to deal with than distance in the other. Such an approach would favor institutional difference over institutional distance. In contrast with institutional distance, institutional difference attaches a value to the direction (and size) of the deviation between countries. From a theoretical perspective, it is important to understand when institutional difference might be preferred to institutional distance, and when distance is likely to matter more than difference.

Finding appropriate empirical measures is key, given inconsistencies in existing empirical results using the same measure across studies. For example, Kogut and Singh (1988) find a negative correlation between affiliate control and cultural distance while Pan (1996) finds evidence to the contrary. A variety of reasons have been given for this inconsistency – measurement limitations (Shenkar, 2001), sample idiosyncrasies (Harzing, 2003), and intervening and moderating effects (Brotherson & Brotherson, 2001; Cho & Padmanabhan, 2005). However, we believe that if we are to make sense of empirical findings, we need a better theoretic understanding of how institutional dimensions are individually and jointly related, and what such theory implies for measurement.

In theorizing about the codetermination and coevolution of the various dimensions, we should remember that multinational firms and their subunits face multiple, nested, and often conflicting institutional environments. In addition, institutions may be nested across levels. Kostova, Roth, and Dacin (2008) argue that institutional distance ought to be defined at multiple levels – subnational, national, and supranational. What levels apply should be determined by the organizational field (DiMaggio & Powell, 1983), action arena (Ostrom, 2005) and the nature of the research question (Aoki, 2001).
Selecting the level of analysis based on these factors is not commonplace. Institutional distance is often measured by comparing two country institutional profiles. This encourages a focus on national-level institutions. While this is arguably easier, using a country level of analysis may not always accurately represent the institutional contexts faced by a multinational firm (Phillips, Tracey, & Karra, 2009). The appropriate level of analysis may be supranational. For example, EU member states have seen a convergence in their business practices and legal frameworks, and foreign firms may, on some dimensions, treat the EU as one region. The appropriate level of analysis may alternatively be subnational. The industry in which the multinational firm is involved can dictate which institutions have greater implications for institutional distance. For example, a firm that enters into a foreign market for consumer electronics would face a very different form of institutional distance than a firm that enters the same country but into the market for electricity generation.

Besides consideration of multiple levels of analyses, the literature could also allow the multinational company a possible agency role. The ideas that international business scholars have applied to the question of institutional distance tend to emphasize that firms are embedded in country-specific institutional arrangements and consider firms to be constrained by existing institutions (Busenitz, Gomez, & Spencer, 2000). Institutions have been assumed to be static. However, institutional environments are subject to change over time and with industrial development, and multinational firms represent an important institutional transmission mechanism (North, 1981). Kostova et al. (2008) and Phillips et al. (2009) point to more recent work and argue that greater emphasis should be brought on the multinational company’s capacity for action. Companies can decide to what extent they will accept existing institutions (Oliver, 1991), and also negotiate, manipulate, and be involved in the construction of the institutional environment in either home or host country. There is anecdotal evidence to suggest that firms can influence government and its policies (Porter, 2000). Seo and Creed (2002) suggest that the likelihood of “praxis” or political action increases as contradictions within and across social systems develop. Since the multinational company faces a context that has a great deal of institutional contradictions, the likelihood of seeing action to influence institutions is relatively high. Work on institutional entrepreneurship (e.g., DiMaggio, 1988) and praxis (Seo & Creed, 2002) can help research on the interrelationships between different institutional distance dimensions and their coevolution.
TOWARD A HOLISTIC MEASURE AND VIEW

As our survey of institutional distance dimensions suggests, much ground has been covered in the study of institutional distance. However, existing research has produced contradictory findings, likely stemming from a relative lack of theorizing, a lack of agreement as to what constitutes institutions, and finally, a lack of convergence in the operationalization of the institutional distance construct. We have raised a number of questions, and the issue remains that we need a better understanding of how different dimensions of institutional distance work, individually and jointly, to affect international business decisions and outcomes.

We believe that a way to encourage the synthesis of existing knowledge is to start by defining institutional distance to include cultural/cognitive, political/regulatory, and economic factors. For reasons detailed in our review of each construct, we believe that the cultural and cognitive factors can be effectively collapsed into one dimension. Similarly, the political, regulatory, and legal dimensions share enough commonality that they may be fruitfully combined into one overarching political/regulatory dimension. Approaching the dimensions in this way and coming to a consensus on the institutional factors that underpin institutional distance represents an important first step in advancing the literature. At the very least it would allow researchers approaching institutional distance from differing disciplinary perspectives to share a common understanding, and hopefully, provide a basis for cross-disciplinary inquiry.

We likewise recommend that scholars that intend to advance our empirical understanding of institutional distance and its impact on international business to include measures of all three dimensions: political/regulatory, cultural/cognitive, and economic. Dismissing any one factor is to ignore the complexity of a system of institutions. Unfortunately, as Aoki (2001) points out, we have been ignoring this complexity “at our peril.” If we continue to focus on one dimension of institutional distance (or subset of dimensions) to the exclusion of the others, we may well continue to produce inconclusive results without being able to account for its causes. We therefore urge that theoretical and empirical work advance based on this broader foundation.

Starting from this common point, examining the questions raised here while paying more attention to multiple levels of analyses and recent research that allows agency on the part of multinational firms will likely help tease out relationships between different dimensions of institutional distance. Although Ostrom (2005) notes that scholars of institutions in
social sciences are becoming more receptive to alternative, multidisciplinary approaches, we hope that the ideas discussed here will encourage researchers to take a broader view and produce a holistic measure that takes account of the complexity of institutional environments.

NOTES

1. Although we describe institutional distance in this study, there have been other conceptualizations of difference across countries. We address this issue later in the paper.

2. Basic gravity models use size and physical distance to explain trade volumes between two countries. GDP is expected to have a positive effect on trade, since a higher GDP suggests higher purchasing power (Bade & Parkin, 2004). More extensive models include borders, language, and historical relationships. Smaller physical distance (Disdier & Head, 2008), shared borders (e.g., Hacker & Johansson, 2001), and common language (Lazear, 1999) reduce transaction costs and thus increase trade. Finally, two trading partners that have had a colony/colonizer relationship share historical links. This bond is expected to have a positive effect on trade (Eichengreen & Irwin, 1998).

3. Most researchers consider cultural and normative distance as the same. Exceptions include Gaur and Lu (2007) and Xu et al. (2004).

4. See Kirkman, Lowe, and Gibson (2006) for the legacy of research that Hofstede (1980) has produced.

5. Conservatism was relabeled embeddedness in Schwartz (2004).

6. Steenkamp (2001) attributes the lack of empirical testing of Schwartz’s measure to the nonorthogonal nature of its dimensions, which makes the use of multivariate statistical techniques difficult.

REFERENCES


C. PEOPLE, SYSTEMS AND ORGANIZATIONS
BUILDING COMPETITIVE ADVANTAGE IN A GLOBAL ENVIRONMENT: LEADERSHIP AND THE MINDSET

Shaista E. Khilji, Elizabeth B. Davis and Maria Cseh

ABSTRACT

Globalization has created an intense competitive environment. As a result, achieving competitive advantage has become the core argument in international management. Some scholars have argued that the development of global leaders is critical (Osland, Bird, & Mendenhall, 2006; Yukl, 2009), while others believe that the global mindset is the key to strategic advantage (Black, Morison, & Gregerson, 1999; Jeannet, 2000; Javidan, 2008). In this paper, we present a review of both literatures (i.e., global leadership and global mindset) to highlight that today’s dynamic marketplace requires a shift in thinking. We conclude by drawing attention to existing gaps in these literatures, and shed light on an emerging integrative model of global leadership and mindset.
Globalization as a concept refers to an increasing worldwide interdependence, and involves integration of economies, countries, and peoples worldwide (Crocker, 2002; Dean, 2005; Govindarajan & Gupta, 2001; Robertson, 1992). It encompasses the international flow and dissemination of ideas, knowledge, and the sharing of cultures (Stiglitz, 2006). Scholars agree that the process of globalization has been proceeding, with some interruptions, for many centuries (Friedman, 2005; Robertson, 1992; Yergin & Stanislaw, 2002). However, what is new about today’s globalization is the speed with which it continues to compress the world (Beechler & Javidan, 2007; Friedman, 2005), and that it is driven mostly by organizations, and not countries or governments per se (Held & McGrew, 2003). Consequently, today’s organizations do business and compete with everyone and everywhere, regardless of national borders. Lane and diStefano (2000) state, “The modern business enterprise has no place to hide. It has no place to go but everywhere” (p. xiii). As noted by Ohmae (1989), on a political map, boundaries between countries may be clear, but on an organizational competitive map, these largely disappear in favor of a persistent flow of information, products, and people.

Thus, today’s global environment is intensely competitive and boundaryless. It is complex in terms of the multiplicity of stakeholders, regulations, cultures, and interests, heightened ambiguity, ethical challenges, the sensitivity with which right decisions need to be made at the right time, and implementing effective global strategies (Bird & Osland, 2004; Lane, Maznevski, & Mendenhall, 2004). It provides organizations with both unprecedented opportunities and formidable challenges (Lane et al., 2004) and forces them to focus on achieving success. Such dynamism and uncertainty has brought “competitive advantage” to the center of frame of argument within international management. Hence, the question, “How can organizations build competitive advantage in today’s globalized environment?” remains hotly debated in the literature. Some scholars have argued that the development of global leaders is critical to competitive advantage (Osland, Bird, & Mendenhall, 2006; Yukl, 2009), while others believe that the global mindset is the key (Bartlett & Ghoshal, 1990; Gupta & Govindarajan, 2002; Black, Morrison, & Gregersen, 1999; Jeannet, 2000; Murtha, Lenway, & Bagozzi, 1998; Levy, Beechler, Taylor, & Boyacigiller, 2007a; Levy, Taylor, Boyacigiller, & Beechler, 2007b).
In what follows, we take a journey from the past and present of global leadership and global mindset literatures to offer avenues for future research. We present a review of both literatures to highlight their respective significance. In addition, we argue that today’s dynamic and complex marketplace requires a shift in thinking. What [globalization] started as a result of integration of economies, countries, and people demands solutions in terms of integration of ideas and perspectives. We draw attention to the existing gaps in literatures, shed light on emerging integrative models of global leadership and global mindset (Beechler & Javidan, 2007; Beechler & Baltzley, 2009a; Davis et al., 2008), and conclude by offering a few research questions for future studies that involve exploring multidisciplinary concepts for a further expansion of both literatures.

LEADERSHIP AND THE MINDSET AS INDEPENDENT SOURCES OF COMPETITIVE ADVANTAGE LEADERSHIP WITH A GLOBAL PERSPECTIVE

A number of leading scholars have argued that leaders who can effectively manage through a complex, ever changing, and often-ambiguous global environment are critical for an organization’s success (Adler & Bartholomew, 1992; Beechler & Javidan, 2007; Caligiuri & Tarique, 2009; Morrison, 2000). At the same time, the worldwide shortage of this unique talent has made effective business leaders sought-after and created an urgency to develop effective global leaders (The Economist, 2006; Mendenhall & Osland, 2002). Hence, it is not surprising that academics and practitioners alike have become increasingly interested in the concept of global leadership (Caligiuri, 2006; Mendenhall, 2006). Below we provide a review of the fundamental facets of global leadership that have received attention in the literature; some more than others, as will be shown in following paragraphs.

Where We Have Been and What Is Global Leadership Now?

In past, the study of global leadership solely focused on expatriate management. However, as the scope of globalization grew, it became clear that the domain of leadership needed to be expanded to include nonexpatriates in
leadership positions. Beechler and Baltzley (2009b) argue that a bias that global leadership is meant exclusively for expatriates (dominantly American in this literature) traveling abroad still exists in several recent publications. In this paper, we focus on literature that emerged when the focus in international business shifted from expatriates to global managers.

Presently, the basic understanding of global leadership varies from the narrow to the broad in the literature. In its narrowest definition, scholars have presented global leadership in juxtaposition to domestic leadership (Beechler & Javidan, 2007, p. 135), emphasizing that global leadership, unlike domestic leadership, spans countries (Adler, 1997; Adler & Bartholomew, 1992; Bartlett & Ghoshal, 1989; Dorfman, 1996). Morrison (2001) argues that national models of leadership generally work well as long as leaders deal primarily with individuals from the same culture; and, because globalization has served to fuse diverse cultures on a global scale, it has rendered models of domestic leadership obsolete. There are other scholars who have defined global leadership in terms of what global leaders are expected to accomplish – that is, to resolve issues of difference – while at the same time creating the conditions to meet the global challenges of diversity, innovation, and competition (Kets de Vries & Florent-Treacy, 1999).

Osland et al. (2006), Beechler and Javidan (2007), and Beechler and Baltzley (2009a) provide a more detailed definition of global leadership; all presenting global leadership as being goal-directed, process-based, and influence-oriented, which is aimed at influencing other people (belonging to diverse cultural/political/social and institutional systems) in order to achieve organizational goals. Morrison (2001) takes a much broader perspective and indicates that global leadership impacts the actions of others on a worldwide basis. This is no small feat, especially when one considers the other challenges such managers must take into account, such as building high-performance organizations, creating new and innovative ways of thinking, devising self-sustainable processes to create strategic advantages (Davis & Smith, 2005), operating in a diverse environment, and constantly mediating value conflicts embedded in global organizations (Trompenaars & Hampden-Turner, 2002).

Despite the aforementioned variations in the definitions of global leadership, which have led to a confusion and fuzziness around the core concept (Beechler & Javidan, 2007; Morrison, 2000), currently, there is a general agreement in the literature that global leadership is the most important, yet rarest and most elusive, type of leadership (Adler, Brody, & Osland, 2001; Gardner, 1996). It is therefore all the more important that global leadership is clearly defined in future research (Beechler & Javidan, 2007; Suutari, 2002).
On a comparative basis, more studies have been conducted that explore what global leadership constitutes. For example, several scholars have focused on the competencies of global leaders as defining global leadership. For example, Brake’s (1997) study presented global leadership as a starting point for how organizations become world-class companies. He then tied it to a triad model of: (1) relationship management, (2) business acumen, and (3) personal effectiveness. At the center of Brake’s triad is the “transformational-self” or the drive toward meaning and purpose through activity strengthened by reflection, personal mind management, and openness to change (Brake, 1997, p. 44). Rhinesmith (1996) identified a wider set of 24 competencies for the global leader. He structured these around three main responsibilities: (1) strategy and structure, (2) corporate culture, and (3) people. Within these responsibilities, he also identified skills, actions, and mindsets of global leaders. However, as this work did not cite any research as a basis for his framework (Morrison, 2000), it was not well received in the literature. In a similar effort to capture the competencies required of global leaders, Black et al. (1999) identified three distinct characteristics of effective global leaders. These included: (1) being savvy, (2) exhibiting character, and (3) embracing duality. They argued that these characteristics transcend context yet are connected to a set of idiosyncratic competencies based on issues of company affiliation, managerial position, country affiliation, and functional responsibility.

Kets de Vries (2005) identified 12 new competencies that he argued were behind a successful global leader ability to deal with change given the discontinuities in the environment and the need to anticipate these changes (p. 32). Similarly, other scholars, such as McCall and Hollenbeck (2002), Mendenhall and Osland (2002), and Goldsmith, Greenberg, Roberston, and Hu-Chan (2003) together presented a total of 75 competencies of global leaders, which included open-mindedness and flexibility, cultural sensitivity, the ability to deal with complexity, honesty, and integrity, being value-added, having integrity, sharing leadership, empowering and developing people, and the ability to build partnerships, etc. Beechler and Baltzley (2009b) identify three new areas that differentiate global leaders from domestic leaders in the literature. They label these as: (1) intellectual capacity, (2) psychological abilities, and (3) knowledge and skills. They argue that global leaders think complexly, have the ability to translate experience and knowledge into effective action. They are open-minded, inquisitive, have self-awareness, possess tolerance for ambiguity, build trust with people who are different
from them, and have superior knowledge of countries and institutions they work with. Indeed, as Beechler and Javidan (2007, p. 138) state that, “the lists of effective global leadership are practically endless, to the point at which they become useless.”

Morrison (2000), in his review of the seminal studies on global leadership, notes that a majority of research related to developing global leader(ship) has been restricted to descriptive essays that are based on small-scale convenient samples and in some cases author’s own consulting experiences in one or two countries. Beechler and Javidan (2007) also suggest that a majority of the global leadership literature is more normative than empirical, with a tendency among scholars to avoid tackling the theoretical challenges in the field. Furthermore, at the Academy of Management Meeting in Chicago, Adler (2009) noted that the field of global leadership has only 14 empirical studies. In light of a dearth of robust research on global leadership to contribute to a collection of empirical evidence and theory development, Suutari’s (2002) conclusion that the field of global leadership is still in its infancy seems quite à-propos.

Is Global Leadership the Same as Cross-Cultural Leadership?

Perhaps the most talked about and researched aspect of global leadership is the role of cultural influences. There are numerous examples of the extent to which leadership is culturally contingent. Collectively, these studies hint that global leadership is not the same as domestic leadership (Morrison, 2000), and thus cater to a narrower aspect of global leadership. For example, Laurent (1983), Trompenaars and Hampden-Turner (1998), Davis and Bryant (2003), and the GLOBE Study by House, Hanges, Javidan, Dorfman, and Gupta (2004) all indicate that effective leadership style found to work in one culture does not necessarily transfer to another without adaptation. The starting point of these studies is the notion of culture, and the primary argument is that culture influences leadership in several different ways. First, early socialization, or growing up, in one culture exposes individuals to prevailing societal values, norms, and practices, such that over a period of time, they learn and internalize the desirable and undesirable modes of behaviors (Smith, Peterson, & Schwartz, 2002), which they tend to exhibit as a leader. For example, a leader in a culture prone toward uncertainty avoidance is likely to avoid risks and prefer more structured and formalized rules and guidelines in the organization.
Second, it impacts the context of the relationship between leaders and followers (Yukl, 2006). For example, a leader in a low power distance culture is likely to be more egalitarian than a leader in a high power distance culture. Finally, scholars have also shown that cultural value orientation in a country shapes the optimum leadership profile in that country (House et al., 2004). Normatively, it follows that better leaders would be those that aligned their actions and attributes to culturally accepted norms and behaviors prevailing in their environment.

Beechler and Javidan (2007, p. 146) argue that cross-cultural leadership (CCL) is a “subset and component of global leadership.” Both CCL and global leadership are based on the assumption that leaders need to understand and manage the differences in order to succeed at their job. However, CCL is focused on leading people from a different national cultural background. On the other hand, global leadership extends beyond culture to understand and address the differences in political and institutional systems. They further explain that CCL focuses on the influence relationship between a leader and a follower, but global leadership also encompasses other stakeholders – people who are neither employees nor the leader’s direct reports, people outside their own organization, and those in external organizations. They build and sustain support in order to achieve competitive advantage. According to this logic, a global leader’s influence extends beyond their employees and organizations.

A dynamic global environment (along with the merging of economic philosophies, the Internet revolution, and technological advancements) and, in particular, emerging evidence relating to convergence and “crossvergence” of individual (leader) values make the transient nature of culture evident. Scholars have shown that, in today’s global environment, a combination of technological/economic as well as sociocultural systems together are systematically guiding countries toward the development of a new configuration of cultural values (Kelley, MacNab, & Worthley, 2006; Khilji, 2002; Ralston, 2008). This fundamental shift in culture may be slow, but is taking place at a pace and in a form that is unique to every culture and country (Ralston, 2008; Khilji, 2002; Witt, 2008). The phenomenon of transition of values presents a substantial challenge to the study of CCL, in that it changes the basis of the discussion from divergence or differences in cultures to integration and reconciliation of cultural values of leaders, their environment, and followers. Consequently, the scope of research ought to extend beyond CCL in developing effective models of global leadership.
MINDSET AS AN ORIENTATION, COMPLEX COGNITIVE KNOWLEDGE STRUCTURE, AND BEHAVIORS

The global mindset is a relatively recent concept in international management. It emerged as a critical success factor for global organizations in response to the heightened competition and the increased complexity of today’s global environment. Harris, Moran, and Moran (2004) argue that global mindset became important to academics and practitioners because of its criticality to long-term strategic advantage in global markets. For example, Gupta, Govindarajan, and Wang (2008), Levy (2005), and Murtha et al. (1998) argue that the global mindset affects a variety of organizational outcomes, such as market power, early mover advantage, lower failure rates, business expertise, and innovation, etc. Jeannet (2000, p. 19) contends that “The global mindset is a requirement for companies competing in the new global economic order.” Numella, Saarenketo, and Puumalainen (2004) assert that having a global mindset is essential for successful internationalization, and Govindarajan and Gupta (2001, p. 2) claim that “Success is all in the [global] mindset.”

Bartlett and Ghoshal’s (1990) primary argument that operating in the complex and dynamic environment requires a shift of thinking from structural and administrative competencies to mindset-based competencies forms the basis of much of the recent literature on global mindset. Levy et al. (2007a), in their extant review of the concept, refer to this argument as the “strategic perspective.” They also identify a “cultural perspective” in the study of global mindset, which focuses on the challenges associated with cultural diversity of people and culturally divergent interorganizational relationships. A cultural perspective suggests that the best way to effectively manage these challenges is to cultivate a global mindset, which exhibits openness, understanding of other cultures, as well as implementing universalistic and supranational approaches to managing (e.g., Adler & Bartholomew, 1992; Doz, Sontoz, & Williamson, 2001; Mazenvski & Lane, 2004; Perlmutter, 1969).

Despite the significance of global mindset to the competitive advantage of organizations (from both strategic and cultural perspectives) and the interest in this concept from both academics and practitioners, it has surprising that it has not become a mainstream topic in international management. In fact, notions of global leadership often overshadow the concept of the global mindset; and below, we review main areas of research related to global mindset to further expand on the meaning and content of the concept.
What Is Global Mindset?

The definition of global mindset has evolved over time, from simply being a state of mind/orientation to a highly complex knowledge structure. Unlike global leadership, where many definitions have ended up making the concept fuzzy, the definitions of global mindset, in fact, complement each other (Hitt, Javidan, & Steers, 2007) to facilitate a broader and multi-dimensional understanding of the global mindset.

Jeannet (2000, p. 11) describes the global mindset “as a state of mind” that is able to understand a business, an industry sector, or a particular market on a global basis. He views global mindset as a toolkit, or a set of analytical tools, that is needed to respond to market opportunities presented by the global environment. In a similar vein, Govindarajan and Gupta (2001) state that global mindset drives discovery of new market opportunities, helps establish presence in key markets and achieve competitive advantage; a view echoed in Rhinesmith’s (1992, p. 63) definition of “an orientation to the world that allows you to see things that others don’t see.” Levy (2005), Levy et al. (2007a, 2007b), and Gupta et al. (2008) move the concept to a higher level, defining it as a “cognitively complex knowledge structure” of individuals that allows them the capacity to balance contradictions, ambiguities, and trade-offs as well provide them with the abilities to manage dualities or paradoxes associated with the global environment. Levy et al. (2007b, p. 27) argues that global mindset (as a highly complex cognitive structure) is “characterized by an openness to and articulation of multiple cultural and strategic realities on the global level, and the cognitive capability to mediate and integrate across this multiplicity.” In addition to the orientation and cognitive structure aspects of global mindset described above, various definitions also reveal a behavioral aspect of the concept. Levy et al. (2007b, p. 24) explain, “… studies describe global mindset in behavioral, dispositional, and competency-related terms such as ‘propensity to engage’, ‘ability to adapt’, ‘curiosity’, and ‘seeking opportunities’, to name a few.”

The global mindset is essentially a “way of thinking” that helps leaders see the world from multiple perspectives, make decisions that work both globally and locally, and enhances the organization’s capability to compete in the global environment (Beechler & Baltzley, 2009b). Bouquet (2005) also refers it to as a way of viewing the world that transcends the parochial demands of individual countries. Mazenvski & Lane (2004, p. 172) provided a more expansive explanation and state that global mindset is, “… the ability to develop and interpret criteria for personal and business...
performance that are independent from the assumptions of a single country, culture, or context: and to implement those criteria appropriately in different countries, cultures and contexts.”

It is clear from the above definitions that global mindset is often viewed at the individual level. However, Levy et al. (2007b) argue that it is a multilevel construct, in that it is not only individuals (alone) who may have a global mindset. It can be shared with others in a group setting. They conceptualize it at the group or organizational level as a “shared cognitive structure, which emerges out of the actions and interactions among individuals” (p. 28). From this perspective, global mindset at the organizational and team level is the aggregation of global mindsets of a group of individuals.

What Does Global Mindset Constitute?

Little research has focused on exactly what a global mindset constitutes. Levy et al. (2007b) contend that a recognition that global mindset is critical to competitive advantage has generated disparate frameworks. As a result, its characteristics remain largely ambiguous. A review of the literature, however, shows that scholars have presented characteristics of global mindset as actions, behaviors, and attitudes.

For example, Jeannet (2000) and Murtha et al. (1998) describe the global mindset as the ability to enforce integration, responsiveness, and coordination of activities. Bartlett and Ghoshal (1998) argue that a global mindset links environmental complexity, strategic demands, and organizational capabilities. Numella et al. (2004) state that the global mindset includes both attitudinal and behavioral elements. Their attitudinal aspect accords with Gupta and Govindarajan’s (2002) explanation that a mindset is a way in which people make sense of the world. Numella et al. (2004), Fletcher (2000), Gupta and Govindarajan (2002), and Kedia and Mukherji (1999) describe elements of the global mindset as a manager’s openness to and awareness of cultural diversity and the ability to integrate it effectively. Gupta and Govindarajan (2002) specifically state that global mindset combines an openness to and awareness of diversity across cultures and markets, with a propensity and ability to synthesize across this diversity. Numella et al. (2004) maintain that global mindset is quite similar to the concepts of global and international orientations. Fletcher (2000) as well as Harveston, Kedia, and Davis (2000) state that the global mindset attitude is reflected in the proactive and visionary behavior of the manager, and his or her readiness to take risks in building cross-border relationships.
While Mazenvski and Lane (2004) argue that global mindset is the ability to develop, interpret, and implement criteria for personal and business performance that are independent from assumptions of a single country, culture, or context, other scholars believe that it is a framework that sets up parameters through which experiences are organized or filtered (Gentner & Whitley, 1997; Gorman, 1992; Senge, 1990; Werhane, 1999).

It is important to note a critical disagreement among global mindset scholars here. While Bouquet (2005) and others (cited above) believe that the global mindset is a set of actual behaviors, Beechler and Baltzley (2009a) disagree. They argue that mindset is neither a behavior nor a competency, rather a “way of thinking,” which represents cognitive views of individuals.

The aforementioned characteristics collectively indicate the multidimensional nature of global mindset. These embody the strategic and cultural perspectives (described previously), and integrate the global as well as local levels of operation. It has, therefore, been suggested that global mindset be assessed as a multidimensional construct (Beechler & Javidan, 2007). Levy et al. (2007b) assert that today’s intensely competitive and complex environment necessitates a paradigm shift to a model in which the cognitive orientations of managers is the basic unit of analysis. They offer three core cognitive properties of global mindset, which are multidimensional in nature: (1) an openness and attentiveness to multiple realms of action and learning, (2) a complex representation and articulation of cultural and strategic dynamics, and (3) a mediation and integration of ideals and actions oriented toward both local and global levels (p. 27). They argue that individuals with the highest level of global mindset are aware of multiplicity of perspectives related to their actions, and are open to learning in order to synthesize and bridge across multiple domains.

WHERE DO WE GO FROM HERE?

Identifying Gaps in the Literature

There appear to be a number of gaps in the existing literature – a dearth of robust empirical studies, a focus on normative and descriptive models, and a lack of rigorous research. These gaps (and others) have been talked about at length in the literature (e.g., see Morrison, 2000; Beechler & Javidan, 2007). We concentrate on two additional limitations that we believe demand utmost attention. First, a majority of research on global leadership and
global mindset is conducted and based in the United States and, to a lesser degree Europe and Canada. This is ironic because the primary issues deal with “global environment and how it has created plentiful opportunities and challenges,” and “how leadership, individuals and organizations are expected to be successful in a diverse political, economic and social environment.” In particular, given the recent prominence of emerging economies in international business by virtue of their FDI and large populations, a lack of research from this domain is a major limitation to the globalization of the global mindset. Morrison (2000) has aptly argued that global leadership is something more than an American, European, or Asian approach to leadership. The expectations for today’s global leader include effectively exhibiting a proactive and open behavior toward diverse cultures and institutions, awareness of changing values, and operating on both local/global levels simultaneously. This is only possible when the leader functions independently of ethnocentrism and single-culture assumptions. Globalization, whether at the level of the industry, business, or individual leader, is all about overcoming cultural differences and embracing best practices around the world.

Second, in a majority of research cited above, global leadership and global mindset have been treated as independent sources of competitive advantage. Few scholars have tried to study the two concepts together consciously and deliberately (Beechler & Javidan, 2007; Beechler & Baltzley, 2009a; Davis et al., 2008; Javidan, 2008). This is surprising especially since effectiveness in global leadership can be facilitated only if the leader has a global mindset to confront strategic and cultural challenges of today’s global environment (Caligiuri & Tarique, 2009). The integration of global leadership and global mindset is clearly needed because, collectively, the two concepts provide a more meaningful model of effective global leadership. As a prerequisite or component of global leadership, a global mindset allows practitioners and scholars to view global leadership broadly, from a “way of thinking” (i.e., mindset) to “way of acting or influencing” (i.e., leadership). Collectively both concepts offer deeper insights into the cognitive structures of global leaders, and help scholars focus on increasing the ability of global leaders to compete in the global environment (Beechler & Javidan, 2007). Davis et al. (2008) argue that integrative model of global mindset and global leadership ought to offer a new paradigm of thinking about leadership to tackle the challenges of complex and uncertain global environment. Below we provide a detailed review of the recent work that offers an integrative analysis of global leadership and global mindset.
A New Direction: Integrating Global Leadership and Global Mindset

Beechler and Javidan’s (2007) work was the first published attempt to integrate global mindset and global leadership. However, their analysis ends up being too narrow focusing mostly on the global mindset. They argue that cognitive complexity is a necessary but not sufficient requirement for successful global leaders and outline three basic attributes of global mindset: (1) intellectual (or knowledge), (2) psychological, and (3) social. They state, the “global mindset is an individual’s stock of knowledge, cognitive and psychological attributes that enable him/her to influence individuals, groups, and organizations from diverse socio-cultural systems.” (p. 152). Javidan (2008) explains that global leaders with high stock of knowledge are aware of different competitors, competitive strategies, understand the industry environment and diverse economic/political systems, and able to identify business opportunities globally. Global leaders with psychological capital have high self-efficacy, optimism, hope, and resiliency to attain success. Those with social capital are connected to a large network of relationships, which they are able to call upon in order to get access to information. They are able to build mutually trusting relationships with people from other cultures and countries. They also explain that these attributes can be developed consciously, over a period of time.

Davis et al. (2008) propose a new model of global leadership mindset (referred to as GLM). It is presented as a multidimensional and complex construct that evolves from an ongoing process of learning and integrates leader’s knowledge, behavior, and orientation in a constantly changing environment. The basis of their conceptual model comprises three critical dimensions at the individual level: behaviors, knowledge/cognition, and orientation integrated through an ongoing learning process (see Fig. 1). Orientation is described as a way of being, whose characterization includes elements of openness, collaboration, awareness, mindfulness, appreciation, flexibility, and cosmopolitanism. Knowledge is the cognitive structure consisting of sense making, systems thinking, integration, selection, analysis, imagination, reasoning, intuition, perception, and judgment. Behavior is defined as an enactment of orientation and knowledge, which includes a propensity to engage, be curious, have the ability to build emotional connections, demonstrate global business savvy, exhibit cultural awareness and appreciation, balance tensions, evidence visioning, and cope with the speed of changing events and technologies. Finally, learning is described as the process that fully integrates the three components of GLM, as they are embedded in a leader’s environment. Their definition of learning is similar to
Lane, Maznevski, and Mendenhall’s (2006, p. 20) understanding of discovering, where “Discovering is about learning and creating. It encompasses a set of transformation processes that lead to new ways of seeing and acting, which lead in turn to the creation of new knowledge, actions, and things. When organizational processes support and incorporate discovering, people explore multiplicity, experiment with interdependence, and articulate ambiguity. Continual discovering helps adapt to the constant flux found in the global marketplace.”

Davis et al. (2008) are critical of Javidan’s (2008) inventory and argue that it measures the global mindset in a static, rather than dynamic, way, and at only one specific point in time. They further content that a key element missing in Javidan’s (2008) model is the role of learning, which lends dynamism to global leadership and mindset and reflects the ongoing development and change of the leaders’ mindset in a global environment. They posit that the learning process is the glue that integrates all dimensions of global leadership and mindset, and creates an ongoing renewal of the GLM. Without learning, there is no effective GLM.

Recently, Beechler and Baltzley (2009a) take a strong stand on integrating global leadership and global mindset. They state that global mindset is the core strength of global leaders. Through their extensive research and analysis, they lay out three foundational pieces of global mindset that make global leaders effective. These include cosmopolitanism (being open-minded and nonjudgmental), learning orientation (having a natural inquisitiveness), and proactive relationships (establishing trust). They argue that a global
mindset helps leaders see the world from multiple perspectives, make decisions that work both locally and globally, and increases the ability of their company to compete in the global marketplace. “Having a global mindset means that an individual or organization has an awareness of the diversity across business, countries, cultures and markets, the ability to develop and interpret criteria and business performance that are independent from assumptions of a single country, culture or context, the ability to synthesize across diversity and decide what is the best course of action, behavioral flexibility and discipline to act. Have a broad enough skill set to adapt to be effective in delivering the course of action, and at the organizational level, a team that can effectively act!”

The above discussion indicates that global leadership and global mindset inform each other conceptually and practically. Global leadership requires global mindset, which in turn provides global leadership with the orientation and cognitive structure to effectively lead in today’s competitive marketplace. It is worth noting here that both Davis et al. (2008) and Beechler and Baltzley (2009a) present learning (willingness, ability, and natural curiosity) as a critical piece in global leadership incorporating global mindset. We believe these models will further expand and revitalize the field of leadership development.

GOING FORWARD

Global leadership and global mindset are exciting new fields in international management. To compete and succeed in today’s complex, dynamic, and uncertain environment, organizations need leaders with a global mindset, who are flexible, adaptable, and are able to transcend cultures. Scholars agree that it is neither new technologies nor systems or processes that can lead organizations to competitive advantage. It is people with a global orientation, cognitive knowledge structure, and appropriate behaviors (Bartlett & Ghoshal, 1989, 2008; Beechler & Baltzley, 2009b; Levy et al., 2007a). Having a strong cadre of global leaders with a global mindset is on virtually everyone’s list of factors that will strengthen their companies’ competitiveness. Morrison (2000) indicates the world has an ever-greater need of effective global leaders to handle a complex marketplace. However, given a shortage of global talent, the supply of global leaders has been falling short of its demand (The Economist, 2006; Mendenhall & Osland, 2002). Such a scenario provides impetus for fresh empirical research on global leadership and global mindset.
Globalization refers to the integration of economies, people, and countries, and has made all of us aware of interdependencies. The challenges associated with it are not simple, and require integrative solutions and merging of ideas as well as perspectives. Therefore, going forward, scholars and researchers must develop integrative models and frameworks of global leadership and global mindset to generate comprehensive analyses of global leadership. As mentioned previously, Beechler and Baltzley (2009a) and Davis et al. (2008) have provided an interesting starting point for further research. Additionally, as has been appropriately highlighted by other scholars in the literature, future studies must be developed to overcome current theoretical, methodological, and empirical challenges. These must provide clearer definitions of global leadership and global mindset, avoid prescriptive and normative models in favor of empirical evidence, and incorporate larger samples from outside the United States. Global leadership focused on cross-cultural aspects must also consider evidence of cross-verging global values to develop well-informed and balanced analyses.

As our review and analysis of the literature suggests there are still important unanswered questions concerning global leadership and global mindset. We focus on the following major questions:

1. Given that learning has been described as a critical piece in recent works, one may ask: What role does “learning” play in the development of effective global leaders? Consequently, how do effective global leaders learn, and how do they impart learning within organizations?
2. Since there appears to be confusion around what global mindset constitutes, another question may relate to: What are the core properties of global mindset? And how can global mindset be operationalized?
3. How can global leadership incorporating global mindset be developed? This should be of particular interest to practitioners and those engaged in leadership development.
4. Given that a review of the literature, mostly emanating from the United States, has brought us to the intersection of global leadership and global mindset, is the concept of global leadership incorporating global mindset universal? What adaptations, if any, are needed for these concepts to be effective across diverse cultures and institutions?
5. It is established (at least in the statements made by various scholars) that both global leadership and global mindset lead to competitive advantage, but the real question to ask is: How do global leadership and global mindset lead toward organizations toward competitive advantage?
We predict that exploring these questions will not be straightforward and most likely involve delving into multiple literatures and disciplines outside leadership and mindset. Such an approach should be welcomed because it will lead to richer analyses and understanding of global leadership.

We conclude with a hopeful note. The field of global leadership and global mindset may be young, but it holds promise for future competitiveness of global firms. At the same time, given current confusion related to multitude of definitions, and diverse understanding of the concepts, it offers much potential for scholars entering the field. Studies, incorporating integrative empirical analyses drawn from diverse samples and multiple disciplines, are needed in order to expand the fields, reaffirm their position in international business, and validate their significance for competitive advantage in today’s global environment.

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TOP MANAGEMENT TEAMS
AND SOCIETAL CONTEXT: THE
INTERNATIONAL DIMENSIONS
OF TOP MANAGEMENT

René Olie

ABSTRACT

Although management scholars have displayed a strong interest in top management teams, surprisingly little research has been devoted to the international dimensions of top management teams including their international diversity and their societal and cultural underpinnings. This paper provides a recent overview of empirical studies addressing the international dimension of top management teams and identifies avenues for future research. Particular attention is paid to the role of the institutional and cultural societal context in shaping the configuration of top management.

INTRODUCTION

The focus of this chapter is on organizational leadership, and top management teams (TMTs) in particular, a topic that has received relatively
little attention in the international business and management literature so far. Inspired by Hambrick and Mason’s seminal paper on upper echelons (1984), management scholars have, in the intervening years, expressed growing interest in organizational leadership and TMTs. Based on the assumption that in most large organizations it is not the individual leader or CEO alone that shapes the strategic direction of the company, researchers have begun to investigate the link between TMTs and firm strategies and outcomes (for overviews, see Carpenter, Geletkanycz, & Sanders, 2004; Finkelstein, Hambrick, & Cannella, 2009). The main body of theory and research originates in the United States and has focused predominantly on themes unrelated to international aspects of top management. This lack of scholarly interest in the international aspects of top management is somewhat surprising given the widespread globalization of business structures and the emergence of international TMT structures as a consequence.

Recently, (US) researchers have developed an interest in the importance of the international experience of top managers and other demographic characteristics for firm internationalization. However, related topics such as the cultural diversity of TMTs have received much less attention. Particularly, the national or societal context of organizational leadership (including both TMTs and CEOs) is an under-researched topic (Bird Schoonhoven & Woolley, 2005; Olie & Van Iterson, 2004). Most empirical research has taken place in US settings, assuming that top management configurations, roles, and responsibilities are more or less culture free. However, there is no a priori reason to believe that this assumption is correct. For example, are organizational leadership structures in US firms really comparable to those in German or Chinese firms? Does the top management in French firms function and operate in the same way as its counterpart in the United States? Can we safely generalize most existing empirical findings to non-US contexts? Evidence suggests that the answers to these and similar questions are not completely affirmative. Top management is embedded in a nation-specific institutional context that shapes the power of management and the roles of individual leaders in a corporate system (Buck & Shahrim, 2005; Lubatkin, Lane, Collin, & Very, 2005; Olie & Van Iterson, 2004). Furthermore, traditions, values, and customs in a society have been found to influence managers’ conceptions of leadership and leadership styles, as well as the acceptance of team-based management approaches (Brothers, Brothers, & Werner, 2000; Hofstede, Van Deusen, Mueller, & Charles, 2002; Kirkman & Shapiro, 1997, 2001; Koopman, Den Hartog, & Konrad, 1999). Evidence also suggests that US organizational leadership styles have some idiosyncratic features that make
them distinctive from top management roles and positions in other countries; e.g., the dominant position of the CEO and the cult of leadership associated with it, the informal designation of the team and the strong focus on individual responsibilities (Crossland & Hambrick, 2007; Olie & Van Iterson, 2004). This implies that “upper echelon” research is much more culture-bound than often assumed.

In summary, the literature has provided us many insights about US-based top management and culturally homogeneous teams, but very little about the dynamics of culturally diverse TMTs and the influence of societal context on top management roles and functioning. The purpose of this chapter is to address this gap in the literature. The first aim is to provide an overview of recent top management studies dealing with international issues. This will inform the reader about the “state of the art” and identify topics for future research. Three types of international issues will be central to this review: (1) the international experience of top managers; (2) the international diversity of TMTs; and (3) the national context of top management. Bird Schoonhoven and Woolley (2005) provided a similar overview covering the period 1995–2004. As an extension to this study, we will focus on the period 2005 through 2009. The second aim of the paper is to explore the institutional and cultural underpinnings of TMTs and to provide a research agenda for future research in this area. In this analysis we focus on the structural and social properties of TMTs and how they are defined and influenced by national governance systems and national cultural values. Three central issues of teams will be discussed: team boundaries, interdependence among TMT members, and leadership centrality (or CEO dominance).

PAST AND PRESENT: RESEARCH ON THE INTERNATIONAL ASPECTS OF TOP MANAGEMENT

Traditionally, organizational leadership research has focused on single leaders such as CEOs, implicitly assuming that the CEO has the ability to determine the company’s fate (e.g., Carlson, 1972; Helmich & Brown, 1972). However, the publication of Hambrick and Mason’s article “Upper Echelons: The Organization as a Reflection of Its Top Managers” (1984) initiated a thriving research stream on the subject of TMTs. Based on Cyert and March’s concept of the “dominant coalition” (1963), the “upper echelon perspective” argues that organizational leadership is principally a
shared activity. Focusing on the characteristics of the executive groups, or the TMT, will thus yield stronger explanations of organizational outcomes than focusing on single top executives (Hambrick, 2007). Empirical research has focused on team composition using individual-based characteristics, such as age, gender, personality traits, socioeconomical background, work experience, organizational and team tenure, and values of top managers to explain firm outcomes (for an overview of these studies, see Carpenter et al., 2004; Finkelstein et al., 2009; Jackson, Joshi, & Erhardt, 2003; Tsui & Gutek, 1999). Other features of TMTs, such as structure and process, have received far less research attention (Finkelstein et al., 2009; Priem, Lyon, & Dess, 1999).

In the first decade following the publication of Hambrick and Mason’s article, the literature was virtually silent on the international, multinational, or multicultural aspects of top management (Bird Schoonhoven & Woolley, 2005; Finkelstein & Hambrick, 1996). A few exceptions include the studies by Norburn (1987) comparing US and British TMTs, and Wiersema and Bird (1993) examining the effects of top management composition on turnover in Japanese firms. In the second decade, this picture changed only slightly. In their review of top management studies addressing international aspects of top management from 1995 through 2004, Bird Schoonhoven and Woolley (2005) were able to identify only 13 empirical studies that addressed issues relating to the international aspects of top management (comprising both CEO and top management studies). Most studies focused on the attributes of the CEO or TMT as a whole as predictors of firm strategies, including international experience and national diversity. None of the studies considered country context, culture, or institutional context (Bird Schoonhoven & Woolley, 2005, p. 266). Although a trend has emerged to include demographic characteristics, such as international experience, to study the link between TMT composition and global strategic posture (Carpenter & Fredrickson, 2001; Tihanyi, Ellstrand, Daily, & Dalton, 2000; Sambharya, 1996), these studies almost exclusively involved US samples, thus only allowing us to understand how US managers from US firms benefited from international assignments.

In order to give a comprehensive overview of the themes and developments in the past five years, we made an extensive research of the literature. For this we used the list employed by Bird Schoonhoven and Woolley (2005) which includes the following titles: Academy of Management Journal; Administrative Science Quarterly; Advances in International Management; Advances in Strategic Management; Journal of International Business Studies; Journal of Management; Organization Science; Research in
Organizational Behavior; and Strategic Management Journal. To this list we added several other peer-reviewed journals (mostly Europe-based journals) that have published articles on international aspects of top management in the years 1995–2004: Management International Review; Journal of Management Studies; European Management Journal; European Management Review; Organization Studies; and Journal of International Management. To expand our focus to a wider global context we also included the Asia-Pacific Journal of Management and Management and Organization Review (available as from March 2005) to check for empirical studies involving Asian samples.

We scanned each individual journal issue for titles and abstracts using key words “TMT,” “Top management (team),” “Executive (team),” “CEO,” “upper echelon.” We selected those empirical studies that addressed international aspects of top management such as national or cultural diversity, foreign experience (including international assignments), or (cross) national context. The results of this search are presented in Table 1.

Although our list of journals is not exhaustive, a few conclusions can be drawn from the overview. The general conclusion of Bird Schoonhoven and Woolley (2005) about the neglect of international dimensions of top management studies still holds. Only eight studies matched our criteria: two CEO studies and six TMT studies. Illustrative perhaps of the overall lack of research interest for international dimensions of top management is that a leading international business journal such as the Journal of International Business Studies did not publish a single article on this topic in the past five years!

Most studies in our list focus on international experience of the CEO and other top managers, or nationality diversity within TMTs. In several studies these are combined into an overall measure of “international exposure.” Whereas previously researchers displayed a strong preference for studying the outcomes of CEO/TMT international experience and nationality diversity (Bird Schoonhoven & Woolley, 2005), research in the past five years reflects a greater balance between “outcome” and “antecedent” type of studies. Four studies examine the outcomes of international characteristics. Except for the study by Athanassiou and Roth (2006) dealing with interpersonal outcomes, all of them focus on firm-level outcomes, including international alliance formation (Lee & Park, 2008), foreign entry mode choice (Herrmann & Datta, 2006), and international performance (Gong, 2006). These studies generally extol the virtues of international experience. International experience (and international diversity) provides top managers with a deeper understanding of international environments, including foreign cultures. As such, greater international exposure will help company
<table>
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<td>Athanassiou and Roth (2006)</td>
<td>TMT</td>
<td>TMTs of 39 global companies</td>
<td>Nationality diversity and international (functional) experience</td>
<td>Top manager's centrality in providing international business advice to the team is a function of individual international experience and the team’s international experience</td>
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<td>Crossland and Hambrick (2007)</td>
<td>CEO</td>
<td>Three-country study (United states, Germany, Japan)</td>
<td>National systems; values, corporate ownership, board governance</td>
<td>The effects of CEOs on firm performance are substantially greater in US firms than in German and Japanese firms</td>
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<td>Gong (2006)</td>
<td>Subsidiary TMTs</td>
<td>TMTs of 370 subsidiaries of 28 Japanese MNCs</td>
<td>Nationality diversity</td>
<td>Greater nationality heterogeneity enhances subsidiary performance</td>
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<td>Greve et al. (2009)</td>
<td>TMT</td>
<td>TMTs of 41 financial companies from 11 different European countries</td>
<td>International experience and nationality diversity</td>
<td>Entry into new foreign markets and new cultural regions are associated with higher levels of international experience and greater nationality diversity</td>
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<td>Herrmann and Datta (2006)</td>
<td>CEO</td>
<td>78 CEOs of American manufacturing companies</td>
<td>International experience (total number of years spent abroad on assignments, in higher education, and/or in a firm’s international division)</td>
<td>CEOs with greater international experience are more inclined to choose greenfield investments and acquisitions over joint ventures, and greenfields over acquisitions</td>
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<td>Lee and Park (2008)</td>
<td>TMT</td>
<td>TMTs of 263 US firms in 14 industries</td>
<td>International exposure (international work experience, foreign education, and country-of-origin)</td>
<td>TMT international exposure is positively associated with the formation of international alliances. This effect is stronger as the level of environmental uncertainty increases.</td>
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<td>Stafsudd (2006)</td>
<td>TMT</td>
<td>TMTs and senior management of 18 large Swedish companies</td>
<td>Nationality diversity</td>
<td>Overall homogeneity of age and tenure increases with hierarchical level; for nationality the opposite is observed</td>
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<td>Van Veen and Marsman (2008)</td>
<td>TMT</td>
<td>TMTs of the 363 largest MNCs from 15 different European countries</td>
<td>Nationality diversity</td>
<td>Nationality diversity in TMTs is more a function of country characteristics than of company characteristics</td>
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management to establish mutually beneficial contracts with alliance partners and avoid potential conflicts in the operation of the alliance (Lee & Park, 2008). International exposure furthermore provides managers with greater confidence in managing international operations; managers with greater international experience will, therefore, be more comfortable in making more risky investment decisions. Thus, Herrmann and Datta (2006) found that internationally seasoned CEOs are more likely to engage in greenfield or international acquisitions than their less experienced counterparts. Finally, national diversity in teams provides reputational information to potential foreign partners about the global mindset of the firm (Lee & Park, 2008), and helps subsidiaries to gain legitimacy in their host environment (Gong, 2006).

Three studies – all from European authors – address the antecedents of the internationalization of TMTs (Greve, Nielsen, & Ruigrok, 2009; Stafsudd, 2006; Van Veen & Marsman, 2008). In a study on financial services from 13 Western European countries, Greve et al. (2009) examined the impact of firm internationalization on the internationalization of TMTs. The argument is that firms pursuing geographically expansive internationalization strategies face greater information-processing demands at corporate headquarters and hence require more international capacity within the TMT. Their findings suggest that this logic is particularly true for entries into new foreign markets and new cultural zones. The two other studies address the issue of the relative underrepresentation of foreigners on European management boards and the role of national context. Despite growing numbers of foreign nationals in TMTs in recent decades, their proportion is still very much below the overall level of internationalization of companies (Heijltjes, Olie, & Glunk, 2003), although substantial differences can be observed between countries (Van Veen & Marsman, 2008). Stafsudd (2006) explains the relative homogeneity of TMTs in Swedish companies through basic social mechanisms such as homosocial reproduction, i.e., people prefer and recruit those who are similar to themselves. Van Veen and Marsman (2008) argue that country factors also play a role. Nationality diversity on boards of companies from different countries mainly results from differences in national governance regimes and differences in managerial labor markets. These factors are more important than company-specific characteristics such as company size, geographic dispersion, and involvement in cross-border M&As.

The role of national context is still the least researched theme in top management studies. During our search, we identified several empirical studies using non-US samples, including studies on Chinese TMTs
(e.g., Chen, Tjosvold, & Liu, 2006; Li & Li, 2009), Taiwanese TMTs (Lin & Shih, 2008), Japanese TMTs (Yokota & Mitsuhashi, 2008), and Czech TMTs (Clark & Soulsby, 2007). However, as they all involved single-country studies and/or did not explicitly deal with the impact of the national context they were not included in our final list of studies. The only study that did fit this requirement is Crossland and Hambrick’s (2007) multicountry study on CEOs and their impact on firm performance, which provides an interesting illustration of the relevance of societal context. They ask the simple question: to what extent do CEOs matter more in some countries than in others? More specifically, the authors address the question whether non-US CEOs have as much power as their US counterparts: “An array of interconnected factors – including national values of individualism and tolerance for uncertainty, a prevailing ownership structure of widely dispersed, well-diversified shareholders who seek share price maximization while having little concern for firm failure, and governance arrangements that tend to give CEOs great power – all align to provide the CEOs of American firms relatively greater latitude of action” (Crossland & Hambrick, 2007, p. 768). Based on a theoretical consideration of three national-level institutions – national values (the degree of individualism and uncertainty avoidance), corporate ownership structures (concentration and stability of ownership), and board governance practices – they argue that CEOs in different countries face systematically different degrees of constraint on their latitudes of action and, hence, the effect they have on company performance will differ. Indeed, the results confirm that CEOs of US companies have much greater influence on firm performance than their German and Japanese counterparts.

EXPLORING THE EFFECTS OF NATIONAL CONTEXT ON TOP MANAGEMENT TEAMS

Whereas the study by Crossland and Hambrick (2007) underlines the significance of macro-cultural and institutional factors for the operation of top management, its primary focus is the CEO rather than the TMT. In this section, therefore, we explore how national context influences TMT configurations, loosely defined as the way TMTs are bounded, organized, and coordinated. Although it is impossible to consider all potential influences of national systems, like Crossland and Hambrick (2007) we will focus in particular on governance systems and national culture. The former is a formal institution, and the latter represents an informal institution.
Beginning particularly with the rise of Japan as an economic superpower in the 1980s, researchers have developed an interest in the role of culture and institutions in explaining national variations in the management and functioning of organizations. Common to these approaches is the idea that societies have developed unique patterns of values and institutional arrangements that generate highly distinct forms of business organizations and management systems. The study of organizations from this perspective can be divided into two broad themes that are more complementary than competing (Buck & Shahrim, 2005; Child, 1981; Hofstede, 2001): the culturalist and the institutionalist. We will draw on these two approaches to examine the national foundations of TMTs.

The culturalist approach looks upon culture as a set of ideas, values, symbols, and meanings shared by members of a particular society (Child & Tayeb, 1983). Hofstede (2001) in this respect speaks of “collective mental programming.” This stream of research tends to focus on cultural dimensions that are situated at the level of the personality. Values and ideas in this perspective form the core of a societal culture and refer to a society’s “broad tendency to prefer certain states of affairs over others” (Hofstede, 1980, p. 5). Members of a society learn these shared characteristics through different stages of socialization processes. Cultural ideational systems are believed to shape national institutions over time, which, in turn, reinforce and perpetuate dominant value patterns (cf. Lubatkin et al., 2005; Olie & Van Iterson, 2004).

The institutionalist perspective draws attention to societal institutions (e.g., Hall & Soskice, 2001; Mayer & Whittington, 1999; North, 1990; Whitley, 1992). These refer to the legal, political, economic, and social arrangements in a society that promote certain types of behavior and restrict others (Scott, 1995). According to North (1990, p. 3), institutions are “the rules of the game in a society, or, more formally, are the humanly devised constraints that shape human interaction.” National institutions determine “what organizations come into existence and how they evolve” (North, 1990, p. 5). The institutionalist tradition is primarily concerned with the structural aspects within organizations, such as the division of labor, career, status, and reward structures that are generated by national institutions (e.g., Lane, 1989; Maurice, Sorge, & Warner, 1980; Whitley, 1992, 1999), or with social expectations and prescriptions based on a variety of institutional norms or rules (e.g., Busenitz, Gómez, & Spencer, 2000; Gooderham, Nordhaug, & Ringdal, 1999; Kostova, 1999).

The emergence of the institution-based view (Peng & Pleggenkuhle-Miles, 2009) has revived the debate about the relationship between culture and
institutions. For many, the two are inextricably interwoven. “Institutions are the crystallizations of culture, and culture is the substratum of institutional arrangements” (Hofstede et al., 2002). Similarly, Crossland and Hambrick state: “(...) We can reasonably expect that strong individualistic values in a country will engender governance arrangements that allow individual leaders to have considerable effect, as in the United States. Conversely, a collectivistic society will tend to put in place governance constraints that assure the inputs and influence of multiple parties, such as in Germany” (2007, p. 776). For others, culture represents an informal institution and can thus be safely subsumed under the heading of the institution-based perspective. Nevertheless, the national culture label and perspective persists in many literatures. For that reason, we believe it is justified to use both labels in this paper.

An important means by which national institutions influence top management configurations is through the laws and regulations that delineate and define the structure of organizational leadership and the power allocation to individual top managers. This legal-regulative aspect is particularly embedded in governance systems. Governance systems define the relationships among stakeholders in the process of decision making and control (Aguilera & Jackson, 2003; Wymeersch, 1998), and thus also the extent to which power is conferred to top management. More specifically, corporate governance systems deal with such issues regarding who is assigned overall responsibility for the organization, the responsibility and accountability of top management, as well as the power and role of individual top managers, particularly that of the CEO. From this perspective, corporate governance systems tend to exert a “coercive” influence on corporate practices and behavior, i.e., they establish a set of explicit legal rules and a set of mechanisms to enforce those rules (Whitley, 1992; Lubatkin et al., 2005). As such, corporate governance practices primarily influence the structural properties of teams.

Cultural values, by contrast, mostly influence team configurations through the societal beliefs, values, and norms that top managers bring to the team of which they are members. As such, they tend to exert a strong “normative” influence. Team research, for example, shows that cultural values influence the expectations of organizational members regarding teams and how they should operate. The two cultural values that have received the most attention in the team literature and are most likely to influence teamwork are power distance and individualism/collectivism (Gibson & Zellmer-Bruhn, 2001). Power distance refers to the extent to which members of a society accept the unequal distribution of power and
rewards as normal characteristics of their society. In organizations, it reflects the amount of power or influence that superiors in an organizational hierarchy have over their subordinates. In high power distance cultures, hierarchical structures and decision making are the norm (Hofstede, 2001). Power distance influences the mental images that managers have of teams. Managers from high power distance cultures, for example, tend to more strongly view teams in military terms: as hierarchical groups with clear tasks and responsibilities (Gibson & Zellmer-Bruhn, 2001).

Individualism/collectivism relates to interpersonal relations: the role of the individual versus the group and the extent to which a society prefers autonomous or interdependent action (Crossland & Hambrick, 2007; Hofstede, 2001). In countries where collectivism predominates, emphasis is put on social ties or bonds between individuals, while in individualistic societies the ties between individuals are loose and people are supposed to look after their own self-interests. People in individualistic societies tend to consider independence, autonomy, and privacy at work important. Organizational members in collectivistic societies are expected to be more motivated by a sense of belonging and to perceive a strong positive relationship between their personal interests and those of the organizational group to which they belong (Hofstede, 2001). Cultural values such as individualism/collectivism particularly influence the extent to which team-based solutions match the expectations of organizational members (Chen, Chen, & Meindl, 1998; Kirkman & Shapiro, 1997) and the ways decisions are reached (Crossland & Hambrick, 2007; Hofstede, 2001; Pennings, 1993). Whereas in individualistic countries, such as the United States, unilateral decisions by the CEO are accepted, in more collectivistic societies, such as Japan, executives will be expected to consult their in-group more thoroughly and tend to make more consensus-based decisions (Crossland & Hambrick, 2007). In the following sections we elaborate on how national-level governance systems and cultural values influence three aspects of teams in particular: team boundaries, interdependence among TMT members, and leadership centrality.

**WHAT IS THE TOP MANAGEMENT TEAM? MEMBERS AND BOUNDARIES OF THE TOP MANAGEMENT TEAM**

Empirical studies of US-based companies have struggled with the issue of how to define or operationalize the TMT (Finkelstein et al., 2009).
Some researchers rely on formal characteristics such as job titles, but use it arbitrarily. On some occasions, the TMT is defined as “all officers above the level of vice-president (e.g., senior vice-president, vice-chairman, CEO) and any other officers who are on the board of directors” (Michel & Hambrick, 1992). On other occasions, the TMT is defined as “the two highest levels” (Wiersema & Bantel, 1992) while in other studies the CEO is used to identify the members of his/her “real” TMT (e.g., Amason, 1996; Athanassiou & Nigh, 2000; Simsek, Veiga, Lubatkin, & Dino, 2005) or the set of top managers in a TMT is made dependent on the strategic issue under consideration (e.g., Jackson, 1992). The various arbitrary ways in which US-based researchers have defined who belongs and who does not belong to the TMT, hints that it is likely that US teams are not strongly bounded, with team boundaries being fuzzy rather than solidly delineated and team members and non-team members not being clearly distinguishable.

This outcome is largely the result of the way the US governance system defines organizational leadership. TMTs do not represent a formally designated group of executives but rather comprise an “inner circle” of top executives (Finkelstein, 1992). The US corporate governance system does not provide a legal basis for a TMT as a separate organ. The highest corporate organ is the Board of Directors, which consists of a mix of executive and non-executive members. However, this organ does not completely overlap with the TMT. In most US studies it is accepted that a TMT not only comprises the CEO and all executive board members but also other high ranking company officers without further specification of the boundaries of the team. In this respect, many top managers function in a dual capacity – as members of the Board of Directors and of the “TMT” – while other non-Board members combine team membership with the management of their own organizational subunits.

A stronger form of team-based organizational leadership exists in governance arrangements with a two-tier board system. This system prevails in several European countries including Germany, Austria, and the Netherlands. In this system, executives and non-executives are split into two different legal bodies: the executive board – or TMT – and the supervisory board. The executive board, or management board, is responsible for the day-to-day running of the firm. The formal role of the supervisory board is to appoint and to remove the executive board, to exert control, and to offer guidance regarding long-term policy making. Since the executive board in the two-tier board system constitutes the formal TMT, membership and group boundaries are more identifiable than in the one-tier system. Members know that they are part of the TMT, while nonmembers
understand who belongs to this group and who does not. The distinctiveness as a group is further reinforced by the fact that membership of this team usually is not combined with that of other teams or groups. For example, an overlap in membership between the management board and supervisory board in the form of CEO duality such as in US companies (Crossland & Hambrick, 2007) is generally not allowed. A similar unequivocal membership status applies to other team members. While, as indicated, in the unitary system team members often head their own subunits, giving rise to potential conflict of identities and loyalties (Hambrick, 1994), team members in the two-tier board system enjoy an official status involving an appointment for a (in)definite time period.

To sum up, corporate governance systems are important determinants of team configurations. They define which persons or group of persons are assigned the task of organizational leadership. Relevant in this respect is the extent to which corporate governance systems support team-based types of leadership by providing teams a legal basis, how they separate members from nonmembers and deal with the appointment of team members.

TMT research has generally ignored the boundaries aspect of team configurations (Finkelstein et al., 2009). However, a key implication is that in teams with stable composition and clear boundaries, a relatively homogeneous group of managers is working closely together and dealing with strategic issues, while in team constellations with more fuzzy boundaries a larger and more diverse group of managers may be involved. For example, the “core team” may be expanded by involving a broader array of participants, or the composition of the “core team” itself may vary as team members that are involved in decision making shift from one occasion to another. Consequently, the demographic profile of these groups will vary accordingly. This makes it unlikely that the demographic characteristics of a single team determine organizational outcomes (Roberto, 2003). In all, the above argument suggests that the more TMTs are bounded, the more organizational outcomes will reflect the values, ideas, and perception of the same group of top managers.

Group boundaries also have implications for the social integration of a team. Clear group boundaries promote group awareness and identity, and enhance a group’s internal integration (Schein, 1985). Fuzzy team boundaries at top management level may lead to lack of cohesion and loyalty conflicts. In teams where top managers are not only members of the TMT, but also represent subunits or constituencies within the organization, “tensions regarding group identities” (Hambrick, 1994, p. 176) may be created which enhance the likelihood of goal conflict and self-interested behavior.
HOW DOES THE TEAM OPERATE?
INTERDEPENDENCE AMONG TEAM MEMBERS

Another issue that has created some debate among US researchers is to what extent TMTs are real teams, or merely top management groups. This issue is related to the degree of interdependence among members in a team or group. Interdependence is an essential characteristic of teams (Kirkman & Shapiro, 1997; Stewart & Barrick, 2000) and refers to the degree to which team members are dependent on and support others in goal and task accomplishment (David, Pearce, & Randolph, 1989; Van der Vegt, Van de Viert, & Oosterhof, 2003). In the United States, individual accountability of top managers is dominant: members are assigned specific fields for which they are responsible. Individual accountability is regarded as essential to maintaining control over performance, while mutual accountability is not a developed skill (Katzenbach, 1997; Lubatkin et al., 2005). In contrast, corporate governance regulations in countries such as Germany and the Netherlands stipulate that the management board shares a collective authority and responsibility for the company. Although top managers may be responsible for a division or function, important decisions are made and borne not by individual managers but by the management board as a whole.

While corporate governance systems define the level of structural task interdependence in a team, another source of interdependence is provided by a team’s dominant values (Wageman & Gordon, 2005). In this sense, cultural values regarding the relationship between the individual and the collective also shape the way in which top managers sit together and interact. More specifically, they influence top managers’ perception of interdependence and how they respond to individual- or group-based accountability (Chen et al., 1998). The collectivistic or individualist orientation of top managers defines their needs and expectations with respect to self-interest, self-reliance, control, and the pursuit of individual goals as opposed to collective tasks and group goals (Hofstede, 2001). Collectivistic values are generally more in line with organizational solutions, such as teams. Research indicates that people’s receptivity to teams and shared leadership tends to be positively associated with collectivism (Kirkman & Shapiro, 1997, 2001). In a similar vein, research evidence suggests that a CEO’s collectivistic orientation facilitates and supports a collaborative TMT environment (Chen et al., 1998; Simsek et al., 2005). CEOs with a collectivistic orientation tend to subordinate personal interests to the goals of the larger group and therefore enhance task-related TMT
interactions such as gatherings. Conversely, CEOs who value individualism tend to pursue individual goals that are often inconsistent with group goals (Earley, 1989; Hofstede, 2001). Thus, Katzenbach’s observation that “nonteams” prevail at top executive levels because the individualist model works most of the time, and because top executives – by aptitude and disposition – do not work at their best in teams, may be more true for the United States than for other, less individualistic societies.

In sum, the degree to which TMTs are really groups of individuals rather than cooperative teams with unitary goals and preferences is very much a function of national governance systems and cultural values. The level of interdependence in a team is expected to have important moderating effects on the effect of team composition on organizational outcomes. The weaker the interdependence among the team members, the less team composition as such will explain organizational outcomes.

THE AUTHORITY OF THE CEO. LEADERSHIP CENTRALITY IN THE TOP MANAGEMENT TEAM

A final debate in the literature is about the relevance of taking the team rather than the CEO as the unit of analysis (Dalton & Dalton, 2005; Finkelstein et al., 2009). Indeed, if the CEO represents the most powerful person in the organization, it will be more appropriate to study CEO values and experiences and their impact on organizational outcomes than team characteristics. This makes sense for the US context, but less so for other societal contexts. The CEO in the US corporate system is generally considered to be the person ultimately responsible for setting organizational strategy. Allthough the board of directors has the most legal authority, the CEO is de facto most powerful person because (s)he controls the allocation of resources, selects key executives, determines rewards and incentives, and mediates between the organization and the external environment through his/her role as titular figurehead and his/her links with other companies (Ancona & Nadler, 1989; Daily & Johnson, 1997; Gupta, 1988; Lorsch & Graff, 1996). French companies are also typically characterized by a concentration of managerial power in the hands of a single individual, the Président Directeur-Général (Lubatkin et al., 2005). By contrast, the position of the CEO in Dutch, Danish, and German boards of management (the top management) is much weaker because this person does not carry individual responsibility and accountability but shares this task formally with other
team members. Thus, the executive power lies with the management board rather than with any one individual. The absence of CEO duality further reduces the power of the CEO. Traditionally, many companies from these countries have a CEO who acts more like a primus inter pares. Consequently, decision making by these boards tends to be more consensus oriented.

Differences in leadership centrality can also be observed in terms of the powers that are assigned to the CEO in selecting, nominating, and rewarding fellow top managers. While in German and Dutch corporate systems the chairman does not have any formal power over his “peers” in these matters, in US companies the CEO is in many ways the “architect” of the executive team (Gupta, 1988).

In sum, leadership centrality is partly influenced by the way national corporate systems define the role of the CEO and his/her formal decision making powers. More specifically, corporate governance systems foster leadership centrality by (i) assigning ultimate responsibility and accountability to an individual leader and (ii) granting formal powers to this leader to appoint and to replace other top managers. Leadership centrality, including power sharing and consultative or consensual decision making styles, is also influenced by the extent to which members of a society accept the unequal distribution of power and rewards as normal (Hofstede, 2001). The centralization of authority in French organizations is generally seen as a reflection of the high power distance and the centralization tendencies that characterize French society (Calori, Lubatkin, Very, & Veiga, 1997; Hofstede, 2001; Sorge, 1993). As Lorsch and Graff note about the dominant position of the CEO: “The position of an American CEO is accompanied by a cult of personality similar to that surrounding the president of the USA. Americans seem to place great value on strong leadership” (1996, p. 777).

As mentioned, leadership centralization will have consequences for the degree to which organizational outcomes reflect the ideas and values of the whole team. The greater the power of the CEO, the less team characteristics will matter in explaining organizational outcomes. The study by Crossland and Hambrick (2007) makes clear that the power of the CEO, and their subsequent role in company performance, varies substantially across countries.

CONCLUSIONS

Upper echelon theory has become an important stream of research in the past 25 years. Although it offers important insights and underlines the
strategic and organizational significance of top management for organizations, upper echelon theory is strongly rooted in American experience explaining US organizations. Our overview of the literature shows that this conclusion still very much holds for empirical research in the past five years. Although top management research has expanded into the global arena by studying the effects as well as the antecedents of international experience and nationality diversity, the literature still has not made much progress in exploring the cultural and institutional boundaries of current research. Next to providing an overview of most recent research in the international arena, the purpose of this chapter was to develop our understanding of the relevance of societal context for team top management configurations, and to underline the relevance of future research in this area.

Our overview suggests that top management configurations differ across countries. Some Western countries reflect the US corporate system in which TMTs do not exist, at least in the legal sense, while in other corporate systems TMTs are explicitly formalized in organizational structures. A similar level of variation could be noted with respect to interdependence and power symmetry among top managers. While some corporate systems are supportive of a kind of US style of leadership in which top management is almost solely personified by the chief executive (Davis & Useem, 2002), other societal contexts encourage leadership arrangements that place less emphasis on an individual person with extensive powers or individual tasks and responsibilities.

As mentioned, there has been some debate in the literature as to what extent “real teams” actually exist at the top of organizations. Some authors have pointed to the relatively independent fashion in which top managers work or prefer to work (cf. Hambrick, 1994; Gupta & Govindarajan, 1986). Others have pointed to the dominant role of the CEO in appointing and replacing other team members (Bird Schoonhoven & Woolley, 2005). The analysis in this paper suggests that the “teamness” of TMTs, or the extent to which TMTs approximate “real teams” may be influenced by societal context. Under the influence of societal institutions, beliefs, and values, top management may display characteristics that are more (or less) in line with “real” teams (cf. Hackman & Wageman, 2005). Relatively lower levels of teamness (or approximations of “real teams”) are more likely to be found in societies that combine informal top management groups, strong individualistic values and responsibilities, and personal leadership roles. Higher levels of teamness (or approximations of “real teams”) are more likely to be found in institutional and cultural contexts that combine a corporate system that clearly defines and delineates top management
groups, assigns collective responsibilities, and restricts the role of the team leader with values that promote collective interests and responsibilities, and egalitarianism. At this point it is worthwhile stressing that the cultural and institutional contexts need to be seen as forces that shape the boundaries and repertoire of acceptable actions available to organizations rather than define them. This also applies to top management behavior: national culture and institutions promote or constrain team configurations and predispose members to specific directions, but they do not determine them. Other factors such as organizational complexity and the personalities of the top managers involved will furthermore influence to what extent TMTs will actually operate as real teams.

Our suggestion that in some countries top management configurations are more likely to approximate real teams, implies that in these countries organizations are more likely to be a reflection of the collective preferences and experiences of the top management group instead of a single individual as maintained in upper echelon theory. Hence, it seems that in some countries, TMTs can be seen as the shapers of organizational direction, while in other countries it is the individual leader that has the greatest impact. In effect, it defines whether it makes more sense to study the impact of executive experiences and personality on organizational outcomes at the individual level or at the team or group level. Overall, it can be expected that team composition will have more predictive validity in societal contexts that are conducive to teams with strong boundaries, interdependent membership, and power that is more evenly distributed among members. In addition to its relevance for team outcomes, team configurations also affect team dynamics. Although a detailed analysis of these influences has been beyond the scope of this paper, on several occasions we have noted how individual team attributes affect the social and behavioral integration in a team, and processes such as information sharing among team members.

We have used the term “configuration” freely to indicate the various ways in which TMTs – whether they are to be considered as “real” teams or as pseudo teams – are bounded, organized, and coordinated. The term configuration, however, suggests that these aspects are interrelated and form an integrated whole. Our analysis also points into this direction. Although the three characteristics are conceptually distinct and can be considered in isolation, they are not independent. Team boundaries and interdependence, for example, seem strongly interrelated. Some stability in membership and boundaries is required if common goals and tasks are to be assigned to a group. Likewise, interdependence presupposes some level of egalitarianism.
Interdependence, furthermore, will not only affect the level of behavioral integration in a group, but is also likely to affect group identity, i.e., social integration (Stewart & Barrick 2000).

While our analysis underlines the importance of societal context in the study of organizational leadership, we wish to make a few comments. Our examples of the national variations in top management principally apply to larger firms. Smaller firms usually employ other legal corporate structures than the ones discussed here. A further note concerns the interaction of institutional constraints and cultural predispositions. In this paper, we have considered institutional and cultural forces as separate, but related. Thus, generally we assume their influence to run parallel and even mutually reinforce each other. However, this may not always be the case. For example, although a team’s task may foster team members to work interdependently (e.g., because the governance system stipulates collective tasks and responsibilities), this “institutional pressure” may run counter to the strongly individualistic values of (some) individual team members. Such may be the case when teams are culturally heterogeneous, as in many multinational companies today. An interesting avenue for further research therefore is to explore how teams that comprise different nationalities operate as a team within a specific national institutional setting.

Another topic for further research is that of effectiveness of team configurations. It can be argued that some configurations are more conducive to team effectiveness in specific contexts than others. Interdependence, for example, is assumed to be more effective in situations of high environmental dynamism than in more stable situations (Hambrick, 1994; Siegel & Hambrick, 2005). Likewise, strong leadership centralization can be more harmful in complex settings than in more simple environments (Eisenhardt & Bourgeois, 1988). Ceteris paribus, it may well be that some societal contexts dispose TMTs to be more effective in some situations than in others.

In all, this paper makes a strong plea for more research on TMTs from an international comparative viewpoint. The research on TMTs has a strong US focus and organizational leadership beyond this context has received only modest attention. In this paper we have illustrated our arguments with examples from Western, particularly European, countries. However, studies of non-Western, non-European countries would be a welcome development. Whereas international studies of organizational leadership may be interesting in their own right, comparisons can also be helpful in highlighting the idiosyncrasies of much current TMT research.
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MANAGING THE FRAGMENTED VALUE CHAIN OF GLOBAL BUSINESS: EXPLOITATIVE AND EXPLORATIVE OFFSHORING TOWARD EMERGING MARKET ECONOMIES

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ABSTRACT

The fragmentation of the production process is a major theme of research in international business. Trade benefits arise from the “slicing up” of the aggregate value chain, as well as the entry of new countries bearing low labor costs. If, initially, multinational corporations (MNCs) relocated only standardized, low-value manufacturing activities in new emerging economies (exploitative offshoring), now they are also offshoring their knowledge-intensive activities (explorative offshoring). In the past, the literature on internationalization was mainly focused on the characterization of the MNC as a specific monolithic organization active in the international production. In the present, numerous analyses have discussed the international location of R&D activities, mainly in advanced countries. The foreign R&D subsidiaries are still tightly linked to the
headquarters, maintaining a controlled position. Future research must address two orders of issues. The first is the progressive autonomy of the foreign subsidiaries, which are more and more developing new and independent lines of research. This process leads MNCs to mobilize and leverage untapped pools of knowledge scattered around the world. The second is the R&D offshoring toward emerging economies. This complex process can be characterized as a move from the smile model discussed extensively by Ram Mudambi (where emerging economies were considered as pools of low-cost labor tout court) to a new model, called here the $\lambda$ (lambda) model (where emerging economies are also pools of skilled labor). This paper will explore these new trends using some illustrative cases: L’Oréal (FR), Pfizer (US), ST Microelectronics (CH), and Geox (I). The cases reveal the double orientation of MNCs toward emerging economies, where both explorative and exploitative offshoring takes place.

INTRODUCTION

This paper aims to shed light on the most recent development in the literature on international business regarding the rationale behind the fragmentation of the global value chain. By doing so it particularly focuses on the triggering factors that lead multinational corporations (MNCs) to offshore research and development (R&D) activities in emerging market economies. Which are the determinants of this emergent strategy? Which can be the consequences?

The fragmentation of the production process is a major research theme in international economics (Gereffi & Korzeniewicz, 1994; Arndt & Kierzkowski, 2001; Gereffi, 1999; Cantwell, 1989), business (Maskell, Pedersen, Petersen, & Dick-Nielsen, 2007), geography (Dicken, 2003, 2007; Dicken, Kelly, Olds, & Yeung, 2001; Coe & Bunnell, 2003), and sociology (Kenney & Florida, 1994). Production fragmentation is related to the growth of international trade and intermediate product exchanges. Fenestra (2003) has explicitly connected the fragmentation of production with the increasing integration of global commerce. Trade benefits now arise because of the entry of new countries bearing low labor costs, and this allows for firms to decrease – often to a surprising degree – their total production costs. This tends to link and integrate the economies of developed and developing countries (Gereffi & Korzeniewicz, 1994).
The “slicing up” of the whole (or aggregate) value chain represents a major change in the new post-Fordist paradigm of production, and is largely discussed by researchers specializing in international business studies (Mudambi, 2007; Mudambi, 2008).

These trends, which are closely related to outsourcing, have enriched the theoretical perspective on the study of the global firm. The globalization of business is no longer just a modality through which MNCs organize the location of their activity, but the result of a multilevel strategy of configuration of internal and external activities. These are coordinated in various localities and through diverse strategies of alliance, through outsourcing and offshoring.

Local production systems have emerged, following specific patterns of clustering which characterize the development of individual regions, countries, and large economic areas. These systems operate as attractors of MNCs and, at the same time, give rise to long-distance global supply chains. The dynamic dimension of this process should also be considered. For example, in the experience of East Asian countries such as Taiwan, Singapore, and South Korea, the initial outsourcing of processes from large Western MNCs producing electronic products transferred technology and new capabilities to local firms. Thus, firms such as the global Taiwanese computer manufacturer Acer emerged from this process as a success story. The works of Hobday (1995), Lall (2001), Saxenian and Hsu (2001), and Unido (2002) for Asia, and Cassiolato’s (1992) examination of South America, have stressed the learning effects that have emerged during these periods in developing countries, with the unwitting consequence for MNCs that many local firms and suppliers have shifted from the position of original equipment manufacturer (OEM), to own-design manufacturer (ODM), and from ODM to own-brand manufacturer (OBM), challenging the competitiveness of the old incumbents.

Studies on global sourcing have stressed the underpinning strategy adopted by global firms, which follow the opportunities of using low-cost producers in developing countries for the more standardized phases of their production cycle (exploitative offshoring). As a first best solution, when market conditions make it viable, capital goes abroad to seek low-cost labor, either through foreign direct investment (FDI) or subcontracting activities. In recent years, the scope of global sourcing has expanded (Lewin & Furlong, 2005; Lewin & Peeters, 2006) with many global firms now offshoring knowledge-intensive activities such as services, R&D, etc. in low-cost countries (explorative offshoring). This process can be characterized as a move in the governance of the value chain from the smile model to
a new model that we call the $\lambda$ (lambda) model, where high-value activities are also moved outside the organizational boundaries of the firm (exploitative and explorative offshoring).

This paper will explore the opportunities, challenges and risks that these new trends imply, by using some illustrative cases of MNCs (L’Oréal, Pfizer, Geox, and ST Microelectronics). In the past, the literature on internationalization was mainly focused on the characterization of the MNC as a specific monolithic organization active in the international production (Dunning, 1993). In present times, numerous analyses have discussed the international location of R&D activities, where these R&D units are more or less tightly controlled from the headquarters, establishing, in some cases, strong autonomous relationships with local partners (Bartlett & Ghoshal, 1990). The future research witnesses the entry of the whole R&D activities of MNCs into the global knowledge game (Doz, Santos, & Williamson, 2001), where the access to external knowledge, combined with newly developed capabilities outside their home R&D headquarter, mobilize and leverage untapped pools of knowledge scattered around the world. In order to manage this process, leading MNCs are now offshoring intensively their R&D laboratories toward the emerging economies, fishing abroad through cooperation with foreign universities and through the building of alliances with their lead customers. In present times, we are witnesses to an internationalization process that not only involves the relocation of labor-intensive activities of MNCs in low-labor cost countries, but also implies a radical global shift in the localization of knowledge and innovation sources.

**EXPLOITATIVE OFFSHORING**

Based on the theory of transaction costs (Coase, 1937; Williamson, 1979), modern analyses of the firm have emphasized the degrees of freedom available to each enterprise to design its internal production cycle. The sequence of the phases, starting from raw material to the placement of the good on the market, may not be assigned to a unique organization, but to a more complex aggregation of producers that coordinate the various phases (Williamson & Winter, 1991). Various types of contractual relations among the productive agents (Williamson, 1996) and various anonymous transactions on the market are typically utilized in the production of a good. Particularly, the emergence of intermediate forms has been the subject of research of many approaches deriving from “contract theory” (Hart & Moore, 1988), principal-agent theory (Jensen & Meckling, 1976;
Grossman & Hart, 1986), and theory of networks as appropriate modes of governance (Belussi, 1987; Powell, 1990). These contributions start from the important assumption of product cycle decomposability. They hypothesize the possibility that each organization configures its sequential production phases throughout a mix of cooperative relationships with other producers and one-shot anonymous market transactions.

Subsequent literature has developed in-depth analyses of different types of production systems, where agents interact in localized or distant technological systems. More or less intense degrees of interaction are organized under particular institutional infrastructures and business arrangements. These systems are defined in terms of knowledge/competence flows rather than flows of ordinary goods and services. The presence of leading entrepreneurs and a sufficient critical mass allows these networks to be transformed into: (a) development blocks (Carlsson & Stankiewicz, 1991); (b) innovation networks (Freeman, 1991; Thorelli, 1986; Thompson, Frances, Levacie, & Mitchell, 1991); (c) complex productive architectures (Henderson & Clark, 1990; Iansiti & Khanna, 1995; Richard & Devinney, 2005); (d) system integrators based on modular design for multitechnology products (Pavitt, 2005); (e) synergic clusters of firms and technologies, which generate numerous forms of interactive learning, exploring new business opportunities (Belussi & Arcangeli, 1998); (f) sectoral innovation systems; and (g) regional innovation systems. These structures represent an intermediate form of market coordination, located between the “regime” of pure anonymous market transactions and the model of “fit by authority”: the vertically integrated firm.

But how far and where can disintegration go? The rise of contract manufacturing in many industries such as electronics or clothing shows that the division of labor can proceed outside the boundaries of the firm. However, these new forms of vertical disintegration are “relational” and not “arm’s length” as occurred in the earlier disintegration between the producers of the first industrial revolution and the makers of specialized capital goods (Rosenberg, 1982). As Sturgeon (2002) and others have shown, contract manufacturing tends to concentrate on routine processes, basic components, and basic services, and thus on relatively simple, replicable activities where there are no strategic advantages. In contrast, product designers maintain their proprietary knowledge of the coordination of the entire production cycle, as well as product innovation. “Loose coupling” systems (Sanchez & Mahoney, 1996) may be required when activities imply quite frequent exchanges of knowledge and the common integration of tacit overlapping skills, but in complex product systems, or
when new product architectures are developed, or, again, in cases of unpredictable interdependencies and uneven rates of change, full integration often appears to be the best option (Brusoni, Prencipe, & Pavitt, 2001).

A close look at how value-generating activities are integrated within a firm’s production cycle has been developed in the business literature. The seminal contribution of Porter in his 1985 book *Competitive Advantage* introduced the concept of the value chain, which entails primary (inbound logistics, operations, outbound logistics, marketing, and sales and services) and support activities (firm infrastructure, human resource management, technologies, and procurement policies). They can be strategically decomposed into different low- and high-value activities. Because activities are not isolated from one another, one value chain activity may affect the cost or performance of another. However, synergies deriving from the vertical solutions are often displaced by high coordination costs, organizational rigidity, scale diseconomies, difficulties encountered in integrating activities, and subsystems whose executions correspond to different logics (Lombardi, 2000), in terms of volume optimization, operational flexibility, adjustment to new conditions, etc. Thus, the outsourcing of value chain activities remains a viable alternative, if it can be performed cheaper and/or better by suppliers, or if it allows the firm to reach a better performance thanks to a reduced lead time, inventory costs, and so forth. For Porter, only nonstrategic activities should be outsourced without putting the competitive advantage of the firm at risk. Therefore, outsourcing is bounded by the risk of losing the firm’s specific competencies or learning potentialities (derived from feedback and the interrelatedness of value chain activities).

Porter associated specific firm competencies to particular segments of the value chain or, alternatively, to the strategic game of the five competitive forces. In contrast, the “resource-based” (Hamel & Prahalad, 1990; Grant, 1996) and “dynamic capability” views (Teece, Pisano, & Shuen, 1997) proposed more thorough reflections on the distinctive competencies of the firm. They are related to the knowledge assets of the firm, its accumulation as immaterial capital, and its problem-solving activity. These are noncodified and tacit, and often difficult to measure and detect. As argued by Winter (1988), firms are repositories of productive knowledge that they exercise, and not merely an economic contrivance of the individuals associated with them. The ability to learn characterizes the core competence of the firm, its routines and the ability to change them, leading to a learning-to-learn activity (Zollo & Winter, 2002). This aligns with the idea of the firm expressed by Nonaka (1994) and Nonaka, Toyama, and Nagata (2000) as a “knowledge-creating” entity. From this stream of literature, we derive the
assumption that the core competences of the firm reside in specific loci of the firm, among which are the R&D laboratories. They are not just a support service such as human resources, information technology departments, etc., but a core component of the firm “intelligence.” The development of knowledge in firms is certainly a complex and path-dependent process, whose origination cannot just be limited to the R&D department. Clearly, as evidenced by Loasby (2000) and Soo, Devinney, Midgeley, and Deering (2002), knowledge in firms develops through a mixture of deliberate decisions, is influenced by day-by-day interactions, rules, and conventions, and also serves to coordinate firms’ internal activity with the activities of their suppliers and customers. Thus, firms develop their internal organizational setting (within their boundaries) together with their “external organization” (Leoncini & Montresor, 2008).

Addressing the issue of the decomposability of the production cycle of firms and of their value chains allows us to better interpret the organizational dimension of the modern firm during the past decades (Dicken, 2003; Stigliz, 2006). The intense globalization of markets has opened up countless business opportunities for the internationalization of the firm, and this phenomenon is not at all restricted to the “old world” of multinational firms (Dunning, 2000). Globalization results in more intense international competition, especially from firms located in low-cost countries, and in striking processes of activity relocation, especially from firms located in Western countries. The internationalization of firms’ value chains is the most direct implication of market globalization. This creates a new model of international division of labor that allows several producers, localized in different countries, to organize their production with the support of business networks, through which raw materials, parts, and components are reworked or assembled (Arndt & Kierzkowski, 2001; Fenestra, 2003). This new model is not based on Ricardian comparative advantages (specialized countries trade goods where they have a superior comparative advantage), neither on a kind of life-cycle theory of product “maturity” stage, à-la Vernon (where the production of mature products migrate in developing countries), but it is based on the integration of dispersed individual production phases that are localized in various different countries (depending crucially on the relative combination of labor competencies and costs).

The “slicing up” of the whole or aggregated value chain represents a major change in the new post-Fordist world (Krugman, 1995). Low-value-added activities, or routinized production, are under more pressure to be externalized and relocated to low-cost countries. In global industries
(Gereffi & Korzeniewicz, 1994; Gereffi, 1999; Gereffi, Humphrey, & Sturgeon, 2005), different activities of the same commodity chain are increasingly spread across national boundaries. Korzeniewicz (1992, p. 314) has defined a global commodity chain as “a set of transnational inter-organizational linkages that constitutes the production, the distribution and consumption of a commodity.” Hopkins and Wallerstein (1994, p. 17) define a commodity chain as “a network of labor and production processes whose end result is a finished commodity.” They emphasize the interrelations and interdependencies between firms and industries, implying that a change in one dimension will affect all other dimensions as well. The focus is on the geographical and organizational fragmentation of production, and on the industrial coordination or governance of the organizationally and geographically dispersed chain of activities. A powerful actor is responsible for planning, financing, and integrating the various productive phases.

Humphrey and Schmitz have proposed replacing the original definition of “global commodity chain” with the more general term “global value chain” (GVC), in order to focus the analysis on “the question of who adds value where along the chain” (2002, p. 10) and avoid the risk of restricting the scope of analysis to standardized products. A critical distinction in the GVC approach is between buyer-driven and producer-driven chains. As explained by Gereffi (1999, p. 41), producer-driven chains are those in which large (usually multinational) manufacturers play central roles in coordinating backward and forward linkages along the value chain. Producer-driven chains are present in technology-intensive industries such as the automotive, aerospace, semiconductor, and heavy machinery industries, where final assembling firms must develop a particular ability using architectural knowledge (Henderson & Clark, 1990). In contrast, buyer-driven chains have emerged among large retailers and distributors, where brand producers have segmented the markets, playing a pivotal role in decentralizing the production networks. Buyer-led chains are dominated by large retailers. They organize the production of labor-intensive and consumer goods industries (garments, footwear, toys, housewares, and consumer electronics). Such large retailers (such as Max&Specker and Walmart) operate in a regime of quasi-oligopoly, characterized by high entry barriers. The most profitable segments of the value chain are downstream, where they relate directly with the consumers (through selling and postselling services). In producer-driven commodity chains, the highest profits are usually in the hands of the industrial firms playing the role of final assemblers. Often, they develop a dominant position over their retailing networks. To stay active in the markets, firms need to exert technological leadership and to
manufacture complex, high-volume products. In buyer-driven chains, technologies are more standardized, but for outsider producers from developing countries, entering the more advanced markets is very difficult because of incumbent retailers who compete by concentrating their investments in areas such as branding, advertising, marketing, and sales, where entry barriers are high. A central claim that Gereffi, the main proponent of the GVC approach, makes is that these two governance structures are not to be understood as mutually exclusive, but as contrasting poles “in a spectrum of industrial organizational possibilities” (Gereffi, 1994, p. 99). The continuous integration of production into modern retailing networks is not deeply analyzed.

Mudambi (2008) has documented the rise of offshoring processes, analyzing what will determine the global geography of economic activity during the coming decades. He argued that the interplay of comparative advantage and competitive advantage determines both the boundaries of the firm (outsourcing decisions) and the optimal location of value chain components (offshoring decisions). An important aspect related to the decomposability of the value chain is that “activities at both ends of the value chain are intensive in their application of knowledge and creativity.” The pattern of value-added along the value chain may therefore be represented by the “smiling curve” (Mudambi, 2008, p. 13). This means that high-value activities (R&D, design, marketing, advertising, brand management, and after-sales services) tend to be largely located in advanced market economies, while those in the middle of the value chain are moving (or have moved) to emerging market economies. Mudambi illustrated the smile model using the case of the handset industry. A similar pattern has also been found by Pyndt and Pedersen (2006), who considered a variegated sample of large Danish companies. Furthermore, several empirical descriptions are found in Belussi and Sammarra (2010), who collected numerous international case studies, and analyzed offshoring processes both as inward and outward flows.

For firms, the offshoring strategy is not just a simple way to cut internal costs (McCann & Mudambi, 2005). It is a strategy of internationalization that potentially has a dynamic evolutionary perspective. Often, firms start to offshore (through captive offshoring or offshore outsourcing) to take advantage of low salaries, but over time they activate a process of incremental learning and move rapidly toward a process of product reengineering. Alternatively, they start to benefit from their new location in terms of innovation and new knowledge absorption (Kenney, Massini, & Murtha, 2009).
EXPLORATIVE OFFSHORING

Complementary to the exploitative offshoring process, which was extensively described in the previous section, there is the explorative offshoring process. The explorative offshoring process has been studied to date as strictly linked to the issue of the globalization of innovation activities. This is related to the worldwide location of R&D laboratories. Archibugi and Michie (1995) developed a taxonomy, in which they defined three distinct categories of technological globalization: (1) the global exploitation of technology; (2) global technological collaboration; (3) the global generation of technology. Explorative offshoring is related to the third category, which is the technological equivalent of FDI. The ability to generate inventions globally is seen as a specific character of MNCs. Traditionally, the MNC is conceived of as an octopus where the brain (the most important assets, such as R&D) is in the home headquarters and the tentacles (low-value-added activities, such as manufacturing) are in the foreign units. Recent events have paved the way for an alternative view of the MNC internationalization strategy. In some cases, which will be illustrated below, the brain blows up, allowing the strategic assets to be decentralized into the tentacles. It is therefore interesting to explore the evolutionary pattern of MNCs’ behavior, and to stress the triggering factors of the new approach to offshoring practices.

Extensive field surveys (Casson, 1991) have underlined that foreign R&D is often used to adapt the product to the market needs, and to provide technical support to the foreign subsidiary. R&D internationalization is mainly the result of accidental actions and not of a carefully well-planned strategy (Granstrand, Håkanson, & Sjolander, 1992; Patel & Pavitt, 1991). In recent years, considerable evidence has been gathered that points to the relevance of knowledge creation by MNCs subsidiaries through tapping into advanced countries for the development of technologies that are complementary to the innovation activity of the parent company at home (Kuemmerle, 1999; Zander, 1999), or to developing new R&D alliances focused on the exploration of radical new technologies with partners localized in the United States and in Europe (Chiesa, 1995; Andersson & Forsgren, 2000). If technology supply is the main reason to go abroad, it is more likely that the location of supplementary R&D activities would be close to already existing centers of excellence, universities, research institutes, or science parks. Foreign R&D labs were very often a duplication of the parent company activities. Considering the localization of extramural R&D activities, Howells (1994, 2000) identified problems of dislocation,
fragmentation, escalation of costs, delays of innovation, and lack of interface between research and production. In essence, investing in foreign R&D was not so much a process of substitution, but rather a process of complementary growth, in the use of both internal and external technical capacities. In fact, Cohen and Levinthal (1989, 1990) have indicated the R&D, and particularly the basic R&D performed in-house by the major international companies as an important means to an effective absorption of external technical knowledge.

MNCs have historically (and often still do) concentrated most of their R&D activities in the home country (Patel & Pavitt, 1991; Edler, Meyer-Krahmer, & Reger, 2002; Macher, Mowery, & Di Minin, 2008; Meyer-Krahmer & Reger, 1999), or have performed technology-seeking FDI in advanced countries (Dunning, 1993; Cantwell, 1995; Archibugi & Iammarino, 2002), because of technological complementarities or higher technological competence.

Firms can either offshore internally by setting up their subsidiaries in foreign countries (captive offshoring), or offshore externally by outsourcing business functions to independent foreign providers (offshore outsourcing). An ongoing debate concerns the identification of the conditions under which the one or the other modality is more advantageous to the firm (for instance, see Kedia & Mukherjee, 2009). Not only is the choice between offshore outsourcing and captive offshoring relevant, so too is the selection of the location for establishing the new units. Historically, Western companies have transferred only low-value-added manufacturing activities to low-cost countries. Only recently have they started to establish R&D labs in emerging market economies (UNCTAD, 2005). Often, the choice of offshoring more advanced activities follows the initial decision to offshore labor-intensive activities (Maskell et al., 2007; Jensen & Pedersen, 2007), within what can be referred to as a sequential offshoring process. Captive offshoring seems to be, not surprisingly, the preferred manner of handling R&D offshoring in relation to developing countries (Cannice, Chen, & Daniels, 2003, 2004). This is coherent with the “core competence” perspective (Prahalad & Hamel, 1990), which suggests that firms should keep their vital functions under strict control, avoiding the leaking of crucial knowledge through outsourcing.

Offshoring can also be associated with the global sourcing of talent, as was well described by Lewin, Massini, and Peeters (2009) in their study on the determinants of innovation offshoring among US companies. The significant skilled labor shortage in the home countries drives MNCs to search for talent abroad, making developing countries that also have
qualified human resources the optimal location choice (low-cost/high-skill) (Asakawa & Som, 2008; Gassmann & Han, 2004; Gassmann & Keupp, 2008). For example, leading MNCs in the field of ICT have established R&D facilities in India. Beyond favorable wage differentials, the triggering factors of this process are the presence of good universities, qualified engineers, and the existence of complementary activities (Archibugi & Pietrobelli, 2003; Jensen, 2009). Similarly, technology-intensive multinationals have explored China as a location for R&D activities (von Zedtwitz, 2004; Xue & Wang, 2001). In 1993, Motorola established the first foreign-owned R&D lab in China and, by 2004, Von Zedtwitz (2004) identified 199 distinct foreign R&D centers established or under construction. The total number of globally important patents originating from non-OECD economies is small compared to the OECD total, but has grown rapidly in recent years (OECD, 2006, 2008; Walsh, 2003). In 1991, Brazil, China, India, and South Africa accounted for 0.15% of the total share; by 2002, this had increased to 0.58% of the total.

To date, only a small number of developing countries and economies in transition are participating in the process of R&D internationalization (see Fig. 1), but this emergent phenomenon might soon spread also to other areas.

THE RISE OF THE LAMBDA MODEL: SOME EMPIRICAL ILLUSTRATIONS

As we have described in the previous sections, not only do firms relocate low-value-added activities to emerging market economies (exploitative offshoring); they also relocate high-value-added activities such as design and R&D (explorative offshoring). Emerging markets have long served as platforms for manufacturing by MNCs, but they are rapidly moving to become platforms for R&D activities.

The global fragmentation of the value chain is characterized by a dual modality of R&D management. In order to stay competitive, firms start to engage in R&D offshoring practices, while maintaining existing R&D labs in the home country. The preferred countries in which to open R&D labs are India and China, mainly because of three important motivations: (1) cost reduction; (2) market expansion; and (3) sequential offshoring.

Cost reduction concerns the objective of reducing R&D costs by employing highly qualified Asian scientists, thus sustaining lower labor costs and
benefiting from a two-way learning mechanism (back and forth between the headquarters and the relocation site). This is quite similar to the reasons that push firms to relocate their manufacturing activities, investing in exploitative offshoring.

Market expansion is connected to the hybridization of home-based knowledge and capabilities with local ones. This might also give the opportunity to initiate new lines of business and/or develop new products, or even create new markets, from a technology speciation perspective (Levinthal, 1998; Adner & Levinthal, 2002). The manufacturing of products for new market niches is then facilitated by the fragmentation of the R&D process. MNCs can therefore embrace long-term business strategies

*Fig. 1. Foreign Location of R&D, 2004 (%). Source: UNCTAD (2005, p. 133).*
(Anderson, 2006) to deal with the continuous decrease in demand for mass products in almost every field.

Sequential offshoring (Maskell et al., 2007; Jensen & Pedersen, 2007) occurs when companies decide to relocate R&D labs after having already established manufacturing plants in the country. The need to keep production and R&D activities close is one of the main drivers of this choice, along with the possibility of reaching scope economies by benefiting from previous offshoring investments.

Due to the motivation listed above, the more dynamic MNCs have increasingly moved their R&D activities in emerging market economies. Low labor costs, market expansion and sequential offshoring are the main objectives leading the change. Learning mechanisms that were previously limited to business and R&D interactions with actors in advanced market economies (through exploitative outsourcing or offshoring) are now extending into emerging market economies. New opportunities are now open, and the potential advantages of the first movers lead MNCs to compete for the best locations and the most promising linkages with local knowledge providers (universities, institutions, and research labs).

The four cases that follow are illustrative of this lambda internationalization model, where not only high labor-intensive, but also high knowledge-intensive activities are moved into emerging market economies. The model is illustrated in Fig. 2. On the x-axis there is represented the value chain, with the inputs of the production process on the left side and the outputs on the right side. The y-axis represents the level of industrialization and modernization of the countries where the production phases take place. On the bottom there are the emerging markets; on the top there are the advanced market economies. Our model has been clearly inspired by

![Fig. 2. The Lambda Model.](image-url)
(and it is an evolution of) the smile model proposed by Mudambi (2008). The main difference resides on the left side of the figure. The smile model is completed with a left whisker that extends the activities performed in the emerging market economies by also including the design and R&D based activities. The smiling curve now resembles a lambda. Therefore the smile model is leaving room for a new model of internationalization of R&D activities, where in some cases new and more science-based research projects are now straightforwardly developed in emerging market economies (without being attracted by the center of gravity of the consolidated R&D headquarter). Here we called this model the “lambda model.” The cases of Pfizer, L’Oréal, ST Microelectronics, and Geox are emblematic cases, which can be also considered as representative of the internationalization strategies of other firms operating in the same industries.

**Pfizer**

Pfizer, founded in 1849 in New York, is the world’s largest research-based biomedical and pharmaceutical company. Pfizer’s best selling drugs (USD 2 billion and more in sales) are Lipitor (cholesterol), Lyrica (neuropathy), Celebrex (arthritis), Norvasc (high blood pressure), and Viagra (erectile dysfunction). In 2008, Pfizer earned USD 48.3 billion in revenues and invested USD 7.5 billion in R&D. The Pfizer R&D network is quite extended (see Fig. 3). Pfizer has been operating in China since the early 1980s. The first Pfizer plant in China opened in Dalian in 1989. In 2007, Pfizer outsourced as much as 30% of its manufacturing to facilities in Asia, particularly in India and China, in order to cut production costs. More recently, it expanded its R&D investments in China, India, Japan, and South Korea. In recognition of the pool of highly skilled and talented scientists in China, Pfizer established its first China Research and Development Center in Shanghai on October 31, 2005. Later, in August 2009, Pfizer undertook a series of initiatives in China to tap into the expertise of Chinese academics and professionals and, as a result, enhance its capabilities in the R&D field. In particular, Pfizer announced partnerships with two leading educational institutions: Fudan University (to create a joint graduate program in clinical research) and the Shanghai Institutes for Biological Sciences (to conduct drug discovery work). Pfizer has expanded its work force at the Shanghai R&D center to 350 from the initial 14. R&D in the pharmaceutical industry is expensive and time consuming; yet, even at a time when most companies are tightening their budgets to weather the
economic downturn, Pfizer is not only maintaining its R&D commitments, but it also intends to increase its investment in China, and will continue to look for more partnerships with Chinese academics and Chinese companies. Pfizer spent USD 150 million on R&D in China from 2005 through to the first half of 2009. In November 2009, Pfizer announced the establishment of a new Pfizer R&D center in Wuhan to serve as a state-of-the-art platform for global drug development and strategic biomedical alliances (Yan, 2009).

What is behind Pfizer’s increasing investment in developing countries? The answer might probably be found by considering the industry specificities. The life science industry is dominated by large pharmaceutical companies. Their strategies are influenced by at least three factors (Garnier, 2008): (1) global pricing pressure; (2) demand from emerging countries; and (3) new diseases. Since 1999, large pharmaceutical companies have faced the nearest-term patent expirations ever (less than four years); the pressure to replace revenues quickly remains intense. Customers around the world are only willing to pay more for truly innovative drugs; in this case, the high R&D costs might be appropriately covered. Yet, there is no standardized evaluation system that allocates fair prices for drugs. In addition, there is a tendency to apply different payer systems in developed and developing countries.
countries, with the consequent risk of selling drugs at not-for-profit prices in poor countries. The reduction of R&D costs by locating laboratories in low-wage countries might be seen as a partial treatment for this “price disease.” The opportunity to save is particularly high in Phase II and Phase III clinical trials, where costs may shrink by 50% if moved from high-cost places to low-cost places. Nowadays, countries with high standards of living account for less than 20% of the world’s population; however, these countries generate 80% of the industry’s global revenues and profits. This is expected to change rapidly, due to a gradual improvement in the health care systems of countries such as China, India, Turkey, and Russia. Being close to this potential new market for drugs is crucial in favoring the connection between the producer and the user, and making it possible to face the emergence of new diseases which trigger demand for new therapies. The fragmentation of R&D activities makes it easier to pursue the development of drugs for limited segments of patients, which then can be further expanded to other segments. An organizational redesign of the industry’s overall efforts is in place. Since large pharmaceutical companies are now abandoning the instant blockbusters to invest in niche-busters, they face the need for multiplying the knowledge sources. There is therefore a tendency to split up their big R&D centers located in the headquarters. A spatial fragmentation of R&D, increasingly involving locations in emergent market economies, seems the only possible strategy for pharmaceutical companies to keep their competitive advantage.

L’Oréal

L’Oréal was founded in 1909. Its founder, Eugène Schueller, created his first hair dye formula under the name Oréal, in which he used a blend of harmless chemical compounds. Schueller filed for a patent (no. 383920) on March 24, 1908. The growth of the company was linked to a series of key acquisitions in the cosmetics, pharmaceuticals, and publishing sectors; over time, these strengthened the innovative capabilities and market power of the firm (see Fig. 4). Today, L’Oréal is the world leader in the beauty industry. It counts 500 brands (23 international), 5,000 new formulas developed yearly, 18 research labs worldwide (see Fig. 5), 100 active research agreements with prestigious universities and public research organizations PROs, more than 4,000 patents registered, more than 1,800 patent applications (628 patents were registered in 2008 alone), and 50,500 employees worldwide. Net sales in 2008 amounted to €17.5 billion.
L’Oréal started to conduct exploitative offshoring activities in China in 1996, after the government relaxed the laws regulating foreign investment in the country. In fiscal year 2004, Asia was one of its most successful markets, with 17% sales growth from the previous year to €1.269 million (USD 1.27 million or 12.48 million Chinese RMB). In China, sales almost doubled – a factor attributed to both the growth of existing brands and the acquisition of Mininurse (a Chinese mass-market skin care brand) in late 2003 and Yue Sai (a local makeup and skin care brand) in early 2004. Over the period of 2003–2004, in Hong Kong, sales were up 36%; they increased by 22% in Taiwan. In 2005, the global beauty giant opened a new R&D center in Pudong, Shanghai, to carry out research into the structure and behavior of Asian skin and hair, in order to develop products to meet the specific needs of the Asian customer. For example, most Chinese women like skin whiteners rather than tanning products; also, the texture of Chinese hair is thicker and coarser than typical Caucasian hair. Skin care is the most
Valuable cosmetics and toiletries sector in China, accounting for 38% of all industry sales in 2005, according to Euromonitor International’s latest research; this market has significant potential for further expansion.

Initially, the strategic plan was to dedicate the 3,000 m² facility just outside Shanghai to makeup, skin care, and hair care R&D. By the end of 2006, L’Oréal expanded its human investment in China by employing more than

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*Fig. 5. L’Oréal’s R&D Labs Worldwide in 2009. Source: 2008 L’Oréal Annual Report.*
60 staff members. Since 2001, L’Oréal has initiated many different competitions among Chinese students, including the “Innovation Lab Challenge,” the “L’Oréal Brandstorm,” and the “Industrial Challenge.” These various competitions have not only introduced college students to the cosmetics industry, but more importantly, have brought a deep and wide talent pool to L’Oréal in regards to creative ideas and future employees. L’Oréal has also enlarged the research fields by establishing biology labs focusing on tissue engineering, and chemical labs to investigate the potential of botanical raw materials that are used in, or inspired by, traditional Chinese medicine. Apart from adapting international brands to Chinese and Asian needs, the research center also supports the internationalization of Chinese brands that fall under the L’Oréal umbrella, such as Yue-Sai.

The motivation behind the choice of offshoring R&D activities in China is at least twofold. On the one hand, there is the availability of low-cost skilled labor; on the other, there is the opportunity for market expansion. Euromonitor International valued the Chinese cosmetics market at USD 7.9 billion in 2005, the world’s eighth largest market for the industry, with sales having almost doubled in the period 2000–2005. The ability to blend the competences accumulated in R&D labs in other parts of the world with formulations designed to deliver the best results for Asian hair and skin gave L’Oréal a real competitive advantage in the market.

**STMicroelectronics**

STMicroelectronics is a global leader in the semiconductor industry. During the past decade, it became the world’s leading supplier of analogue integrated circuits (ICs), system-on-chip architecture (SoC), and numerous semiconductor solutions across the spectrum of microelectronics that have been developed with a close relationship with “lead users.” STMicroelectronics was founded in 1987, though the fusion of the Italian SGS Microelettronica and the French Thomson Semiconducteurs. In retrospect, it is difficult to imagine that STMicroelectronics would have become a great success story within the semiconductor industry, which was long dominated by American and Japanese companies. At the end of 1980s, the two European companies were suffering from excessive levels of debt and inefficient management brought on by their state-owned status. After the merger, a sharp reorganization took place in the management of the firm.
The firm developed an almost “a-centric structure,” with key roles assigned to “internal entrepreneurs” who were able to direct their resources to identify “the right task for the right people” (Cuomo, 2003). The impact of new technologies implied the end of a verticalized standard model (Macher, Mowery, & Simcoe, 2002), calling for a vast number of new applications requiring detailed and customer-specific products. In line with this trend, the company’s technological dynamism was also supported by a large network structure of R&D alliances, and close relationships with key customers. Knowledge that could not be developed internally (or through key alliances) was absorbed externally thanks to the strong links built with universities in the United States and Europe. STMicroelectronics activities are organized through a network which includes 13 productive sites located around the world, and 16 separate R&D units. Europe, China, and Asia are the main reference markets (see Fig. 6). R&D expenditures in 2008 were USD 2.15 million, more than 20% of total sales. In the past 10 years, employment levels have grown from 17,000 to 50,000. In fiscal year 2008, the total sales reached the USD 9.84 billion.

As discussed in our contribution, the smile model is applied as regards the production activities. Assembling and new product tests are mainly located in developing countries (captive offshoring): there is one site in Morocco,

![Fig. 6. The STMicroelectronics Offshoring Strategy. Source: STMicroelectronics website. Available at: www.st.com/stonline](image)
one in Malta, two in Malaysia, two in China (Shenzhen and Longgang), and
one in the Philippines. On the contrary, the production of the crucial
component, “the wafer,” is a tightly controlled “in-house” process, whose
manufacture is globally distributed between the main units localized in the
advanced economic areas.

It has been demonstrated that despite globalization, several multinational
firms continue to conduct little research outside their home base. This
observation does not characterize STMicroelectronics. Since the 1990s, the
architecture of its R&D labs and alliances has been truly international,
covering Europe, the United States, and Asia; currently, the expansion of its
R&D activities is also being directed toward the developing economies of
China and India.

Its activities in Singapore include R&D, manufacturing and its Asia
Pacific HQ, which employs over 5,300 staff members.

In 2006, STMicroelectronics announced a cooperation agreement with
the Beijing University of Posts and Telecommunications (BUPT) and
Beijing Jiaotong University (BJTU) to establish a microcontroller labora-
tory in each university campus. In 2004, the company signed a joint venture
agreement in China with Hynix Semiconductor to build a front-end
memory-manufacturing facility.

Starting with just four employees in 1987, STMicroelectronics’ operations
in India have come a long way, evolving into an organization with nearly
2,200 employees, including 450 in the ST-Ericsson joint venture, who
are major contributors to STMicroelectronics’ worldwide success. Among
the pioneering visionaries of the industry, ST was one of the very first
microelectronics companies to recognize India’s potential and, by 1990,
had begun its design operations in the country. STMicroelectronics’
advanced R&D centers at Greater Noida (1,800 researchers) and Bangalore
(50 engineers) are contributing significantly to almost all key application
segments of the company.

ST’s design teams in India specialize in very large scale integration (VLSI)
design, embedded software development, application engineering, and
company information systems. Since 1999, ST has been operating a joint
laboratory in Bangalore with the Indian Institute of Science (IISc).

The company’s designers in India are developing libraries for future
32-nm generations. ST in India has filed over 600 patent applications
worldwide (300 original inventions), of which the first 100 have now been
granted. The Indian team has created a low-cost, ready-to-manufacture
reference design for an Indian set-top box manufacturer, which is the first of
its kind for the Indian market.
The case of STMicroelectronics shows how the company has shifted its high-value R&D activities over time, first through a complex alliance architecture, and second through implementing a model of R&D offshoring (captive offshoring), which has followed the logic of the so-called lambda model. This has implied the implementation of a decentralization model, where R&D activities are relocalized in emerging market economies, and a new open model of innovation is activated to unlock the locally-imprisoned knowledge of the subsidiaries, as presented by Doz et al. (2001, p. 833).

Geox

Mario Moretti Polegato founded his shoe company, Geox, almost by accident, in 1995, and turned it into the world’s second largest shoe manufacturer, after the UK’s Clarks. One day, he was running in the desert in Nevada when he got really fed up with how sweaty his feet were. Back in Montebelluna, the famous Italian district of sport shoes and makers of ski and mountain boots, he started talking to technicians at the local universities about designing a sole that would allow feet to breathe, but which would also be waterproof. The technicians at the ENEA center of Padua University came up with the solution of using materials from NASA spacesuits – a micropore membrane that could act as a second skin (polytetrafluoroethylene – PTFE). This material possesses about 1.4 billion locks per square centimeter; each is 20,000 times smaller than a drop of water, but 700 times larger than a vapor molecule. Thus, this membrane is waterproof, yet breathable, since it allows sweat vapor to exit (Camuffo, Furlan, Romano, & Vinelli, 2008). Polegato quickly patented his idea. In creating breathable soles, Geox registered over 40 patents.

The company’s patents involve products, processes, and manufacturing equipment. R&D is carried out in close partnership with research centers and universities in Tokyo and Milan. In 2008, Geox sold 23 million pairs of shoes, making sales of €892.5 million in 68 countries around the world; it now sells through 10,000 independent multilabel shops and 724 single-label Geox shops (data up to December 31, 2007).

Although product innovation is concentrated on the shoe sole, Geox’s managers are aware that the upper’s aesthetics and style remain important factors in customer preferences. Originally, most new products (season and flash collections) were designed at the company’s headquarters in Montebelluna. In 2001, however, a new design center was set up in the Marche, where a leading footwear district is located. Geox’s chain of
production was created in Montebelluna during the 1990s. At the same time, the majority of firms in the district (Belussi, 2010) sent the more standardized and low-value segments of their value chain abroad, activating a delocalization process. Thus, the firm followed the smile model previously discussed: while in the beginning all intermediary productive phases were outsourced to other firms in the district, at the end of the 1990s they were entirely offshored. Actually, the “made in Italy” Geox shoes are produced outside Italy – in 28 countries around the globe.

In 1997, new establishments were built in Slovakia (400 employees) and Romania (2,000 employees), in Timisoara, where a large factory that produces about 2.5 million pairs of shoes a year and employs about 7,000 people was opened. Actually, about 55% of production is currently subcontracted in larger volumes in East Asia. At the end of the 1990s, Geox moved to China, signing a long-term manufacturing agreement with an established shoe producer that possesses autonomous design capability – the Aokang Group of Shanghai, a Chinese shoemaking company whose production is based in Wenzhou (Zhejiang province). Aokang Shoes alone, which has a staff of over 16,000, has become a MNC in the past few years. The company has more than 30 subsidiaries, over 3,000 franchise stores, chain-operated specialty stores and sale outlets across China, and over 800 store-in-store outlets. In the past years, the company has opened three design centers in Wenzhou, Guangzhou, and Milan. This company possesses nearly 100 patent applications related to its proprietary innovative technologies, such as an improved middle sole and nano anti-germ technology. For this reason, Geox resorted to a strong alliance in R&D activities and in distribution. In the past year, Geox has opened nearly 140 shops in China with Aokang and has moved its Italian R&D center to Oubei and Dongguan in the Guangdong province of southern China. Geox represents a clear case of globalization of R&D activities (described here through the lambda model) that involves emerging market economies.

DISCUSSION AND CONCLUSIONS

It has been argued (Chiesa, 1995) that, in the past, R&D internationalization was focused on adaptive R&D (downstream activities), or on locally focused R&D (for the development of original products for the local market), or, again, on more adjunctive global R&D but within a narrow mandate in a centrally coordinated R&D. In present days the importance of external knowledge sourcing and the wide adoption of “open innovation” models by firms (Chesbrough, 2003) is changing the competitive global
game. Multinationals (Doz et al., 2001) tend to unlock the knowledge locally imprisoned in their subsidiaries in order to implement a more distributed R&D network organized around the various company-owned R&D labs and around more autonomous external R&D alliances. The patents granted to competence-creating subsidiaries reveal this new trend (Cantwell & Mudambi, 2003). Companies need to accelerate the introduction of technical progress, and to overcome the increasing specialization of R&D, bringing new knowledge and tapping into new centers of excellence. The systemic nature of innovation requires the integration of different disciplines: this fosters companies to combine several external pools of dispersed competences. Time-to-market processes are nowadays shortened, and firms must have access to near-to-the-market applicable knowledge combining pools of diverse expertise (Frost, Birkinshaw, & Ensign, 2002). To sum up, R&D internalization is losing its “center of gravity” within the old MNC headquarters. This process is clearly slow and much differentiated, depending of the individual strategy adopted by each MNC. Our analysis is very preliminary and is only based on few cases. Our list sketched above is far from being exhaustive. However, we found as verified the hypothesis that a nonmarginal fraction of the bulk of the R&D activities in the studied MNCs is shifting from the more advanced countries to emerging market economies, and particularly to China and India.

The analysis of the four case studies illustrated above gives important insights into the dynamics of R&D offshoring processes. Despite general agreement on the smile model proposed by Mudambi (2008), the cases support a new interpretative model of R&D offshoring which complements his original contribution: the lambda model.

In all observed cases, cost-reduction objectives were the principal motivation for starting offshoring activities. Moreover, the analysis of the internationalization trajectories of Pfizer, L’Oréal, and Geox confirms the existence of a sequential offshoring process. What we wanted to pinpoint here is that the choice of R&D relocation in emerging market economies is related not only to costs reduction opportunities, but also to the availability of a pool of knowledge and capabilities considered as crucial for the future competitiveness of the relocating companies.

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GLOBAL MARKETING STRATEGY: PAST, PRESENT, AND FUTURE

Susan P. Douglas and C. Samuel Craig

ABSTRACT

In examining the issues relating to global marketing strategy, scholars have primarily focused on marketing opportunities in the developed world. Recently, rapid rates of growth in emerging market countries have resulted in a growing interest in the market potential of these countries. Developing a global marketing strategy to target these diverse types of markets suggests the need to develop divergent strategies for different types of markets rather than focusing on integrating strategies across markets. To date, however, little is known about how to achieve this effectively. This paper briefly reviews past approaches to these issues and then indicates critical topics for future research.

INTRODUCTION

In international marketing, academic research has evolved over the years. To a substantial degree this has been based on the key issues faced by large US multinational corporations (MNCs), as they expanded their operations outside of the United States. In Europe, with some exceptions, attention has remained to a great extent on issues related to exporting since the majority
of firms involved in international markets are exporters. Thus, research has tended to parallel operations and key concerns in the broader business community. As a result, research in the United States initially centered on decisions relating to initial market entry: how to assess opportunities and competition in international markets, and decide which country or countries to enter; how to enter international markets, that is, via exporting, licensing/franchising, a joint venture, or wholly owned operations; and the timing and sequencing of international markets, that is, whether to be an innovator and move preemptively into international markets or rather be a fast follower.

Once having determined where and how to enter international markets, the firm then needs to develop its marketing strategy within each country – selecting the target segment and determining how far to standardize its marketing strategy, that is, product, positioning, price, promotion, and distribution, or alternatively to adapt in order to respond to the needs and characteristics of the market segment and the nature of the market infrastructure. In addition, as the firm builds operations within a market, management will need to determine whether to expand its product line by adding new product variants, and in some cases, by developing new products to meet specific customer needs and interests.

As national barriers have declined and markets have become increasingly integrated due to technological advances in physical transportation and communications such as the Internet, containerization, etc., firms have increasingly coordinated and integrated operations across national markets on a regional or global scale to achieve efficiencies and potential synergies. In many industries – e.g., automobiles, telecommunications, and consumer electronics – attention has been paid to developing products for global or regional markets, and to transferring ideas, knowledge, products, and best practices across markets. The impact of this trend has become an increasingly important focus for research in recent years.

Interest has also begun to emerge in understanding markets such as the four large BRIC markets, and exploring the extent to which individualized marketing strategies need to be developed for each of these countries. Issues related to tapping the large markets of rural poor (India and China), or urban poor (Brazil) in these countries have also begun to emerge, focusing to a large extent on the practices followed by domestic firms in these markets.

This chapter reviews previous research in each of these areas, relying primarily on research reported in the US literature and US-based journals. Issues of current interest such as the integration of global marketing strategy, global market segmentation, and global branding are also reviewed. The chapter concludes with a discussion of critical areas for future research,
that is, understanding emerging markets, including second tier Next-11 (N-11) markets, the trend away from aspirations of American/Western values and lifestyles toward growth of national cultural and economic identity, understanding conditions for the effective transfer of ideas, products, and best practices, and the increasing emphasis on decentralization of management decision-making.

**THE PAST**

In examining the issues relating to international marketing strategy, in the past scholars have primarily focused on three principal areas: (1) procedures to determine which countries to enter initially and what modes of operation to adopt, that is, exporting, licensing, joint ventures, etc.; (2) examining whether standardization vs. adaptation of the marketing mix is optimal; and (3) global integration of marketing strategy, including global branding, and global market segmentation. These studies have been both conceptual and empirical, relying in some cases on theoretical concepts borrowed from psychology, social psychology, linguistics, as well as strategy, economics, international business, etc. Each of these areas is briefly reviewed, indicating key substantive knowledge in each.

*International Market Entry*

The conceptual foundations for studies relating to international market entry decisions often derive their inspiration from the international business literature. Here, one major stream of thought emphasizes a transactions cost perspective (Anderson & Gatignon, 1986). This proposes that firms internalize, that is, undertake themselves production and distribution functions in overseas markets, when it is more cost-effective to do so, as opposed to buying or contracting out production and distribution functions to other firms in the open market. This perspective has, for example, been adopted in developing models to evaluate alternative modes of entry, governance, and channel structure in international markets (Buckley & Casson, 1998; Hill, Hwang, & Kim, 1990).

Another school of thought (Johanson & Vahlne, 1977, 1990) focuses on the process of internationalization. This is viewed as an essentially incremental process associated with the acquisition of information, and development of contacts in foreign markets. Thus, companies go initially to similar neighboring countries via export, then move gradually into more
distant countries and become involved in joint ventures or establishing wholly owned subsidiaries. A number of empirical studies applying this approach to study the internationalization of small- and medium-sized Swedish and Norwegian businesses have been conducted, which confirm the gradual nature of this process (Mattsson, 1986).

**Exporting**

Studies of the characteristics of exporting vs. nonexporting firms and the link to success in international markets, factors influencing export performance, promotion, and financing of exports, and the role of trading companies, for example, have been conducted. Examination of small exporter characteristics invariably concludes that management attitudes and commitment to international expansion are crucial to success (Dichtl, Koeglmayr, & Mueller, 1990).

Another area that has been investigated is the link between firm size and exporting activity. Here, again, there are conflicting findings, as some conclude that size has little impact on export involvement and activity (Czinkota & Ursic, 1991; Schlegelmilch, 1986), while others conclude that size constitutes a significant barrier to exporting and affects planning, information gathering, and performance (Samiee & Walters, 1990).

Investigation of exporting practices shows variation in the degree of planning, information search, and adaptation of marketing mix policies to specific foreign markets by firms and industry (Seifert & Ford, 1989). The type of strategy pursued in terms of segmentation, product, and pricing has also been found to have a significant impact on export performance (Cooper & Kleinschmidt, 1985).

Some attention has also been given to examining the role of government and other agencies, trade missions in promoting exports, and providing information relating to international markets (Seringhaus & Botschen, 1991). Often this is seen as crucial in stimulating exporting, especially among small businesses. The role of US export trading companies and the export services which they offer has also been examined, often with an explicit or implicit comparison to other similar organizations such as general trading companies or export management companies (Bello & Williamson, 1985).

**Joint Ventures**

Joint ventures have also been examined both from a theoretical and from an empirical perspective. The transaction cost paradigm has, for example,
been applied to understand joint ventures (Beamish & Banks, 1987). They have also been studied from strategic behavior and organizational theory perspectives. Recent approaches emphasize and integrate examination of competitive factors as well as cost and control in examining motivations for joint ventures (Kogut, 1988).

Empirical studies of joint ventures focus primarily on joint ventures in developing countries, examining issues such as the adoption of minority ownership positions in certain countries (Franco, 1989), and differences in instability rate between joint ventures in developing and developed countries (Beamish, 1985). With the opening up of markets in the former Soviet Union, the risks and difficulties of creating and managing joint ventures in these types of markets have also been studied (Rosten, 1991).

Factors influencing the success or failure of joint ventures (Geringer & Hebert, 1989) have also been a key theme, including characteristics of partners, ownership structure, and joint venture management. These studies clearly conclude that joint ventures pose considerable management problems and are often highly unstable.

Country Choice Strategies

Country choice strategies appear to have attracted relatively little interest. One study dealing with diversification via related and unrelated acquisitions (Hisey & Caves, 1985), and another with country portfolio strategies (Perlitz, 1985) as growth strategies and a means of managing risk in international markets were identified. This absence of interest may in part be a reflection of the journals selected for inclusion in this paper, and also the focus on marketing issues. Another possible explanation is that many companies already have operations in foreign markets, and hence, the primary concern is expansion of existing operations rather than entry into new country markets. Such issues are covered in the subsequent section dealing with global rationalization of strategy.

Local Market Expansion: Marketing Mix Decisions

The marketing mix has received the greatest attention in the international marketing literature over the past seven years, focusing, in particular, on the standardization/adaptation issue. While initially emerging in the early 1960s in discussions concerning international advertising strategy, this issue sparked fierce controversy in the mid-1980s with the appearance of Levitt’s (1983) article “Globalization of Markets,” which argued for the inevitability
of global brands and global marketing. The theme and variations of it tend to run through much research not only relating to product policy and branding and advertising, but also other areas of the marketing mix such as sales promotion, distribution, and pricing.

The Global Standardization Debate

Levitt's article (Levitt, 1983) triggered the publication of a number of articles discussing the advantages and limitations of global standardization. These included both general discussions of the issues involved (Douglas & Wind, 1987) as well as empirical studies of the extent to which firms actually pursue global or regional standardization (Rosen, Boddewyn, & Louis, 1989). Such general discussions typically conclude that Levitt's argument that the key to success in an increasing international world is the marketing of globally standardized products and brands, is a gross oversimplification of the issue (to say the least). While in some instances, global standardization may be highly effective and reduce product and advertising development costs, there are numerous pitfalls in such a strategy (Douglas & Wind, 1987), and the appropriate response is dependent on the specific circumstances (Theodosiou & Leonidou, 2003). The number of cases of successful global standardization is limited to a few highly visible examples such as Coca-Cola, Marlboro, Sony Walkmans, Rolex watches, etc., and often requires tailoring to individual businesses (Quelch & Hoff, 1986).

Empirical studies of global branding (Hollis, 2008) typically confirm that the number of global and Euro-brands is relatively limited. In most cases, some modification and adaptation is required, for example, due to language and phonetic association differences. Others (Friberg, 1989) have pointed out the difficulties encountered by companies with established national brands in moving toward greater harmonization on an international scale.

Product Policy

Studies relating to product standardization and modification parallel those in the general standardization/adaptation debate, but focus more specifically on product-related issues or specific types of product markets and countries (Walters & Toyne, 1989). In general, the discussion and issues are similar to those of the general case, although often greater emphasis is placed on identifying opportunities to facilitate product uniformity.
The growth of global competition has generated increasing interest in new product development in international markets. Here, attention has been focused on issues such as whether to design and develop products with global markets in mind initially, rather than for domestic markets (Walters & Toyne 1989). Here, it is generally concluded that a global orientation is more desirable and that innovative European and Japanese multinationals are moving in this direction (Kotabe, 1990). Alternative approaches such as modular or core product design which facilitate greater product uniformity, while allowing for local modifications, have also been discussed (Walters & Toyne, 1989).

Advertising

As with the general discussions of standardization vs. adaptation, the studies examining standardization of advertising strategies and copy, typically conclude that the degree of standardization varies depending on the product and countries covered. Most such studies either compare campaigns for the same medium in different countries (Whitelock & Chung, 1989), or alternatively question executives about the degree of standardization in their international advertising (Hite & Fraser, 1988). The degree of standardization observed tends to vary according to the study and the method or questions asked. Some report a high degree of standardization, while others suggest that this is low (Whitelock & Chung, 1989).

A myriad of studies have also been conducted comparing the content of advertising messages in different countries. Much of this focuses on comparing the informational content of advertising messages in different countries, often the United States vs. other countries such as Sweden (Martenson, 1987), China (Rice & Lu, 1988), and the UK (Weinberger & Spotts, 1989). Typically, the focus is on magazine advertising, although some studies have focused on TV advertising in countries such as the UK, Australia, and Mexico, all high-TV cultures (Weinberger & Spotts, 1989; Gilly, 1988). These often find significant differences in information content and appeals from one country to another. Another group of studies focuses on the advertising environment. These include studies on advertising regulation in various countries (Boddeywn, 1988), and studies of trends in advertising expenditures and advertising to sales ratios (Keown, Synodinos, Jacobs, & Worthley, 1989).
Distribution

Management of distribution practices also appears to be sadly neglected. A few studies examining influence and power relationships in different countries such as Japan (Johansson, Sakano, & Onzo, 1990) and India (Frazier, Gill, & Kale, 1989) were identified. These found differences in the effectiveness of different influence strategies. In Japan, aggressive influence has been found to evoke resistance and conflict, while more subtle influence strategies reduce conflict. In India, on the other hand, high-pressure influence strategies by field representatives are positively related to manufacturer’s perceived power.

Pricing

In the case of pricing, company practices seem to have attracted relatively little attention. Factors to consider in export pricing (Cavusgil, 1988) have been suggested. The role of pricing in the marketing strategies of the United States and foreign-based companies has also been compared (Samiee, 1987). With sharp fluctuations in foreign exchange rates resulting in price differentials between countries, concern has emerged with regard to the growth of parallel importing and gray markets (Cavusgil & Sikora, 1988). Here, attention has shifted from descriptive studies of the phenomenon and regulatory aspects toward the effectiveness of different strategies to counter parallel importing (Cavusgil & Sikora, 1988).

A related stream of research examines various aspects of countertrade for firms dealing with countries that lack hard currency. These range from discussions of the various forms of countertrade such as offset, barter, buybacks, clearing arrangements, etc. and their advantages and limitations (Aggarwal, 1989), to discussions of countertrade in specific regions such as Asia-Pacific (Wills, Jacobs, & Palia, 1986), China, or developing countries (Okoroafo, 1988). Empirical studies of countertrade practices and factors influencing their success (Lecraw, 1989) have also been conducted, as well as economic analyses of patterns of countertrade (Hennart, 1990).

CURRENT TOPICS

As developments in communications technology and physical logistics have facilitated the movement of goods, people, ideas, technology and knowledge...
across national borders (Appadurai, 1990; Featherstone, 1990), firms have responded by moving toward increasing coordination and integration of operations across national boundaries at different levels of the value chain. This trend has led scholars in international business to examine the strength and direction and characteristics of this trend (Rugman, 2005; Ghemawat, 2003), as well as the implications for the organization and management of the firm’s activities and performance (Birkinshaw, Morrison, & Hulland, 1995; Zhou & Cavusgil, 2002).

Some researchers have focused on the geographic scope and configuration of activities (Rugman, 2005; Rugman & Verbeke, 2004), while others have focused to a greater extent on configuration and coordination issues (Roth, 1992; Craig & Douglas, 2000; Zou & Cavusgil, 1996), as well as the factors underlying the speed of the integration of the firm’s activities (Knight & Cavusgil, 1996, 2004). Yet, others have continued to examine the impact on the degree of the firm’s responsiveness to local market characteristics and the organization of its operations (Birkinshaw et al., 1995). In addition, the effect of integration on the conceptualization of a global marketing strategy and the firm’s performance has been an important consideration (Zhou & Cavusgil, 2002; Yip, 2003).

In examining the scope of the firm’s operations, some scholars have argued that strategy development occurs primarily at the global level (Yip, 1995, 2003; Griffith, Cavusgil, & Xu, 2008; Zhou & Cavusgil, 2002; Hout, Porter, & Rudden, 1982). Some (Ghoshal, 1987) have adopted a normative approach in suggesting factors that need to be considered in developing such an approach. Others have pointed out (depending on one’s definition of a multinational) that many tend to be regional in scope rather than global, or organized on a regional basis, for example the auto industry (Ghemawat, 2003; Rugman, 2005). Other researchers (Craig & Douglas, 2000) have suggested that the geographic scope of a firm’s operations and the degree of their interlinkage can provide an important competitive advantage in building market presence and position, providing strategic flexibility and facilitating rapid deployment of resources and assets.

The speed and manner in which the integration of operations across countries takes place has also been examined. Here, an important factor has been found to be the size of the firm and the nature of its target market. Small firms in business to business markets have been found to develop strategy on a global basis immediately, facilitated by the development of information technology, which enables them to rapidly identify potential customers and their needs on a worldwide basis. These have been termed the “born global” firms (Knight & Cavusgil, 1996, 2004) and have been an
important subject of study in recent years. Similarly, firms targeting global market segments such as teenagers, young adults, or high-income consumers typically adopt a global strategic approach and a global product positioning, in order to develop global brand visibility and achieve distribution and advertising efficiencies.

The impact of global strategy development on performance, as well as the barriers to global strategy development and the role of market globalizing conditions, have also been examined (Zhou & Cavusgil, 2002; Samiee & Roth, 1992). Here, the focus has tended to be on performance (Zhou & Cavusgil, 2002), although organizational performance – i.e., strength of strategic position, competitiveness, and global market share – has also been considered. In general, emphasis tends to have been placed on examining the positive role of integration, and to assume that this is the dominant trend, rather than considering the case where the reverse flow, that is, a shift toward local responsiveness is taking place.

Global Market Segmentation

Another issue which has attracted considerable attention has been the growth of global market segmentation (Hassan & Blackwell, 1993). In the past, this has tended to focus on the identification of segments based on traditional segmentation bases such as demographics, that is, teenagers, gender, and income. More recently, however, attention has shifted to a greater focus on behavioral and attitudinal segments.

In the case of behavioral segmentation this has focused on identifying segments based on similarities and differences across different geographic units. Again, in the past, this has tended to use the country as the basic geographic unit of analysis due to the existence of barriers to trade between countries, for example, tariffs, product regulation, as well as the lack of an integrative market infrastructure (distribution, media) (Steenkamp & ter Hofstede, 2002). More recently, the removal of such trade and infrastructural barriers and the increased flow of information across countries has tended to result in increased integration of product markets across countries – e.g., EU and LAFTA – leading to the use of alternative geographic segmentation bases. These include cross-national segmentation studies based on purchase behavior of consumers in major cities worldwide, or urban consumers in different countries. Equally, cross-national studies have been conducted comparing purchase behavior for a specific product
category based on geographic regions within countries (ter Hofstede, 1999; ter Hofstede, Steenkamp, & Wedel, 1999; Steenkamp & ter Hofstede, 2002).

A very large body of research has concentrated on attitudinal segmentation. In cross-national research in the 1960s and 1970s, a key theme was negative consumer attitudes toward products of foreign origin (Papadopoulos & Heslop, 1993), resulting in the development of a scale of consumer ethnocentrism (Shimp & Sharma, 1987), which has been widely used (as both a dependent and independent variable) in cross-national studies. More recently, this has broadened into an examination of the impact of animosity toward a given country on attitudes evaluation and purchase of products from that country (Klein, Ettenson, & Morris, 1998; Nijsse & Douglas, 2004). However, as increased interest has emerged in identifying global segments, attention has shifted toward positive rather than negative attitudes toward products from other countries.

This in turn has aroused interest in the concepts of cosmopolitanism and world mindedness (Cannon & Yaparak, 2002; Cleveland, Laroche, & Papadopoulos, 2009; Thompson & Tambyah, 1999; Nijsse & Douglas, 2008). Some view cosmopolitan consumers as those who, in contrast to parochial, locally oriented consumers view themselves as “citizens of world and are interested in products from other countries as a means of acquiring status within their society” (Cannon & Yaparak, 2002). More recent research emphasizes openness to adoption of products and ideas from other parts of the world and willingness to experiment and “engage with the other” (Cleveland et al., 2009; Nijsse & Douglas, 2008). Such consumers are more likely to purchase unfamiliar foreign products, luxury products, globally popular apparel, etc., as well as products positioned as foreign or global (Alden, Steenkamp, & Batra, 1999).

Closely related are segmentation studies based on the extent to which consumers perceive themselves as part of a global consumer culture (Alden et al., 1999, 2006). These focus on examining the extent to which such consumers are more likely to be exposed to media influences from other countries, travel internationally, prefer entertainment, furnishing, and clothing perceived as popular in other countries around the world, as well as preferring global brands, and be responsive to products positioned as foreign or global rather than local. Studies of specific demographic segments suggest that some segments – e.g., teenagers – may tend to glocalize, or rework global cultural practices and attitudes to fit their local cultural context. Thus, as youth culture diffuses globally, it may also be translated, appropriated and creolized to fit local social structures and issues (Kjelgaard & Askegaard, 2006).
Another area which has attracted considerable attention in recent years is that of global branding (Hollis, 2008; Kapferer, 2008) and the extent to which increased market integration (consumer travel and exposure to global media, cost efficiencies) has generated a shift from local to global brands. Here, issues which have been examined include what a global brand is, consumer attitudes and perceptions toward global brands across different countries (Baker, Sternberg, & Taylor, 2004; Holt, Quelch, & Taylor, 2004) and characteristics of consumers who prefer global brands. Management issues have also been examined, such as, for example, the management of the international brand portfolio (Douglas, Craig, & Nijssen, 2001), alternative procedures for transitioning from a local to a global brand (Kapferer, 2008), and the value associated with a global brand (Steenkamp, Batra, & Alden, 2003).

Views concerning what is a global brand differ. Academics define a global brand as one that has global reach, and a uniform positioning, marketing mix and image worldwide (Quelch, 1999; Yip, 1995). There is considerable controversy as to what is a global brand, and whether in fact global brands, that is, brands that have the same positioning, brand name, product line, etc., worldwide, actually exist (Hollis, 2008). So called “global” brands tend to be predominantly corporate-level brands – e.g., Coca-Cola, IBM, Microsoft, GE, and McDonald’s – and also mostly from the United States (Interbrand, 2009). However, many diversified consumer goods companies, such as Unilever, P&G, and Nestlé, focus predominantly on product-level branding, resulting in greater diversity. Even where a product line may have a common name across countries, product variants marketed under that brand name may vary from country to country, as seen in the cases of Crest, Oreo, and Ariel.

In general, studies of consumer global brands (Holt et al., 2004; Baker et al., 2004; Steenkamp et al., 2003) suggest that consumers have strong positive attitudes toward global brands perceived as global. Consequently, this adds value to the brand. Some consumer segments – e.g., older, traditionally oriented, and ethnocentric consumers – tend to prefer local brands, although knowledge of the country of origin of a brand has been found to be frequently low or incorrect.

Studies of corporate brand portfolios (Douglas et al., 2001) of European-based companies suggest that these are extremely varied. Given that these have historically consisted of a substantial number of local national brands due to country-centered organization and strategy development,
trends toward integration of markets, availability, and reach of global or regional media, as well as rising media costs have created pressures to coordinate brand strategy across country markets (Schuiling & Kapferer, 2004; Kapferer, 2008). This has been reinforced by acquisition of local brands by companies expanding into other country markets. Techniques for transitioning from local branding to regional or global branding have ranged from using both brand names for a period of time, to superimposing the corporate brand name on product brand, or adopting a common logo but retaining the local brand name (Kapferer, 2008). On the other hand, US companies tended to use the reverse strategy, leveraging US brand names internationally but adapting brand positioning or developing brand extensions.

Procedures for managing the international brand portfolio, and for monitoring consistency of brand image and brand extensions have also been examined (Douglas et al., 2001). Again, these vary considerably across companies depending on the diversity and size of the product portfolio, as well as the geographic scope of operations and the firm’s administrative heritage. An individual at corporate headquarters, may, for example, be appointed global manager, or a lead country given responsibility for monitoring and establishing consistency of branding across countries. Alternatively, international brand manuals may be established at corporate headquarters. Regional or global brand teams consisting of managers from different countries and/or regions may also be established.

**CRITICAL FUTURE TOPICS**

Moving into the 21st century, a number of rapid and dramatic changes are taking place in the global landscape. In the first place, as growth slows in mature markets in developed countries, greater emphasis is being placed on growth and opportunities in emerging markets. However, at the same time, competition is emerging from both large MNCs and smaller firms from these markets, as they target markets in the developed world. Second, as these markets grow in importance, they are developing their own sense of cultural identity. This raises the issue of whether the dominant trend of Americanization or Westernization in global markets is at an end and is likely to be replaced by locally or regionally centered tastes. The increasing diversity of markets both within and across geographic areas/national boundaries also raises the issue of how far ideas, products, and best practices can be transferred across markets. Consequently, greater attention
needs to be paid to understanding the conditions under which transfer can be effectively achieved. At the same time, the broadening geographic scope of operations, and the diversity of market environments, suggests the need for more attention to responsiveness to the local context.

This creates a need for more effective decentralization of management, and integration of input from local management into global marketing strategy. All of these factors suggest that a globally integrated marketing strategy is unlikely to be effective, and that the expectation of achieving global synergy is an illusion.

**Understanding Emerging Markets**

As greater emphasis is placed on opportunities in emerging markets, firms from developed countries need to understand in greater depth the diversity of these markets. This ranges from the four large BRIC country markets – China, India, Brazil, and Russia – to the smaller N-11 markets (Wilson & Purushothaman, 2003; Wilson & Stupnytska, 2007). Here an important issue is to understand that not only is there considerable diversity between these markets, but also within these markets.

Although the four large BRIC countries are all large markets (from over 1 billion in the case of China and India, and over 150 million in the case of Russia and Brazil) and have high rates of economic growth, the N-11 markets, which include South Korea, Mexico, Turkey, Egypt, Iran, Pakistan, and Nigeria, are considerably smaller and, in some respects, more diverse. They all share high rates of economic growth and rapidly increasing populations as well as significant industrial capacity, but differ in terms of political stability, as well as the stage of economic development, and hence the importance of an emergent middle class.

These countries are, however, characterized by considerable within-country diversity in terms of urban vs. rural consumers, wealthy vs. poor, as well as regional and age differences, all of which impact on consumer attitudes, consumption, and purchasing patterns. China, India, Nigeria, and Pakistan are all characterized by a sizeable rural population (in India and China over 60% of the population), while Brazil and Mexico have a substantial number of urban poor. The challenges in reaching these consumers vary considerably. In rural areas, accessibility and lack of a market infrastructure are key problems (Prahalad, 2006; Prahalad & Hammond, 2002; Mahajan & Banga, 2006), as are low levels of consumer income and
institutional voids (Ricart, Enright, Ghemawat, Hart, & Khanna, 2004). In urban areas, on the other hand, issues of affordability and deception due to lack of product and promotional regulation are more critical.

Linguistic, cultural, and social heterogeneity results in market fragmentation, for example, attitudes toward the status of women differ from one region to another in India, impacting on use of appeals to women, and impeding the use of women as distribution agents or in personal selling roles. Equally in many countries there are marked differences in food preferences, often related to differences in agricultural production from one area to another. Lack of a well-developed market and communications infrastructure impedes market integration, resulting in the perpetuation of these differences.

Increasingly, firms from emerging markets such as Tata, Haier, Mahindra and Mahindra, Infosys, and Bombardier are expanding into developed country markets, challenging the dominance of established MNCs. These firms are not only able to leverage the advantages of low labor and resource costs in their domestic markets to build their position in global markets, but they are also learning to adopt the technologies and management skills of developed country firms and, in some cases, surpass them in terms of innovation and creativity. As a result, developed country firms need to assess how to respond to these challenges to their home market dominance in their domestic markets, as well as in other international markets.

The growth and increasing significance of emerging markets as a major component of world markets suggests that MNCs from developed countries need to pay increasing attention to exploiting opportunities in these markets and responding to competition from these countries. In particular, they need to consider how to develop strategies to reach a broader mass market rather than leveraging strategy used in developed markets to tap high-income urban consumers who are likely to have similar tastes and interests to those of consumers in developed countries.

The unique characteristics of consumers in emerging markets, coupled with infrastructure inadequacies, suggest that experience and skills developed in industrialized countries are likely to be of limited value in emerging markets (Arnold & Quelch, 1998). Rather, firms will need to create strategy de novo, developing knowledge on the fundamental underpinnings of consumption and the way in which local resources and capabilities, such as labor and social networks, can be developed and utilized to meet consumer needs (London & Hart, 2004).
Growth of National Economic and Cultural Identity

In the past, attention has tended to focus on examining the extent to which American or Western values and attitudes, lifestyles, tastes, and behavior, and consumption patterns have spread or been adopted in other parts of the world (Ger & Belk, 1996; Craig, Greene, & Douglas, 2005). Here an important issue has been the extent to which consumers in other countries, particularly younger and more affluent consumers in less-developed countries, aspire to products and services that are icons of the United States or Western culture (e.g., McDonald’s, Levis, and Nike) or, alternatively, have developed hostility toward such products (e.g., Coca-Cola, McDonald’s, and Barbie dolls) as destroying or contaminating their traditional culture and values.

More recently, a strong sense of economic and cultural nationalism has begun to emerge in a number of countries, notably the larger BRIC countries. In these countries, consumers are increasingly taking pride in their own cultural heritage and buying local brands that reflect traditional styles and aesthetics, and are tailored to their specific needs. Examples include Tanishq and TBZ jewelry in India, and Gome electronics and Geely cars and scooters in China (Prasso, 2007). An interesting issue is the extent to which this sense of economic and cultural nationalism will spread more widely to other countries, and, in particular, smaller countries resulting in the emergence of stronger regional cultures, for example, SE Asian, Middle Eastern, or African. Equally, how Western companies should respond to this trend poses some interesting questions.

At the same time, as this trend toward economic and cultural nationalism emerges, traditional cultural values and behavior patterns are evolving, especially among young consumers. Thus, young urban consumers in China enjoying a greater degree of affluence are abandoning the traditional tendency of previous generations to save, and spend in some cases ahead of their income. They are shifting from collective values to greater individualism, and have aspirations of modernizing, but on their own terms. Thus, the younger generation is competitive and wants to achieve, but not to be conspicuously ahead of others. This results in a creolization of tastes and values, where values and lifestyles of a Western culture become integrated into the local cultural context (Kjelgaard & Askegaard, 2006).

Equally, as a result of increased communication and movement across national borders, cultures, values, tastes, and behavior patterns are increasingly being transferred across countries and cultures. This is not only a one-way flow from developed to developing countries, but increasingly a
two-way flow from one country to another. Increasingly, levels of migration result in immigrants bringing with them the products and behavior patterns of their home countries. These then become adopted and absorbed by members of the host culture, and often change and become adapted to tastes of the host culture over time, for example, pizza. This results in hybridization, as elements of different cultures become comingled (Pieterse, 1995). For example, Japanese art forms such as anime have come to permeate US advertisements, but also take on a substantially US character.

These changes toward, on the one hand, stronger cultural identity and nationalism, but at the same time greater comingling of values and tastes across countries and cultures are not well understood. As cultural values, tastes, and life styles are becoming increasingly deterritorialized – i.e., not geographically bounded – their impact is becoming increasingly complex, particularly in terms of the implications for behavior as consumers. Consequently, greater attention is needed to understanding the dynamics of these trends and their implications for international marketing strategy.

Transfer of Ideas, Products, and Best Practices

As noted earlier, a key traditional theme in international marketing (Levitt, 1983; Buzzell, 1968; Jain, 1989) has been the standardization of products and brands worldwide. However, as firms expand further afield into more diverse markets, the situation becomes more complex. Rather than considering the leveraging of products and strategies developed in home or other lead markets, the firm may focus on the leveraging of ideas and best practices or the skills and capabilities underlying successful strategies. This requires an understanding of the conditions under which ideas and best practices can be effectively transferred from one market to another. Here, the role of contextual factors such as urban vs. rural, societal affluence, or religious influences may be important considerations. Equally, the development of the soft market infrastructure – i.e., distribution channels, the media infrastructure, as well as the firm’s organizational structure and administrative heritage – are likely to be important factors facilitating effective transfer of ideas, skills, and capabilities.

Ideas, skills, and capabilities are most effectively transferred to countries with similar environmental conditions and market infrastructure. Insofar as markets in developed countries are similar in these respects, ideas,
capabilities, and best practices developed either in a lead or in a trend-setting market in one country can typically be adopted by other countries. Japan may be somewhat of an anomaly in this respect. Although it is a trendsetter with regard to fashion and miniaturization, its distribution channels are lengthy, complex, and highly fragmented.

Similarly, as noted earlier, differences in the soft and hard infrastructure as well as differences in consumer needs and ability to pay in emerging markets imply that skills and best practices from developed countries can rarely be easily transferred to these markets, especially in relation to rural areas. On the other hand, products, processes, and skills developed in one emerging market may be effectively transferred to other emerging or developing countries with similar demand and resource conditions. For example, SABMiller developed low-cost production processes for developing beer targeted to low-income consumers in South Africa. These processes were then replicated in other countries in Africa and markets throughout the world with similar demand and resource conditions. Similarly, experience in dealing with specific types of distribution structure, for example, highly fragmented systems, or competitive conditions or pricing in an inflationary environment can be transferred to other countries with similar conditions.

Effective transfer of skills and experience from one country to another also requires the establishment of effective mechanisms to stimulate the flow of knowledge relating to marketing operations and conditions from one country to another (Gupta & Govindarajan, 2000; Foss & Petersen, 2004). A global information system can, for example, play an important role in sharing information about marketing conditions and best practices in different parts of the world, as well as providing secondary and primary data at the macroeconomic and product level.

Increased mobility of marketing managers across countries also stimulates the transfer of ideas and know-how within the corporation (Roth, Sweiger, & Morrison, 1991). Exposure to different market conditions and competitors in other markets stimulates ideas with regard to the use of different competitive tactics under different conditions, and in response to specific types of competitors in other markets.

The administrative heritage and organizational structure of the firm is also likely to impact the transfer of ideas and experience. Firms involved in exporting and operations that are organized on a polycentric basis are less likely to transfer information and experience across markets than those that are organized on product division, regional or globally integrated basis. Ultimately, however, management attitudes at the senior management
level are likely to be critical in ensuring openness to transfer of ideas and experience and the development of a global mindset.

**Effective Decentralization of Management**

The expanding geographic scope and increasing diversity of the markets in which firms, whether MNCs or small- and medium-sized firms, are operating gives rise to an increasing need for responsiveness to the local environmental context. This may be less marked among firms with a highly focused marketing strategy on a specific target segment worldwide. However, even in this context, understanding and responsiveness to local market conditions may be needed. Achieving local responsiveness suggests a need to give increasing responsibility to local management in establishing direction for the firm’s efforts in a given market and providing input into marketing strategy formulation and implementation at the local level. Equally, the diversity of consumer tastes and interest both between and within countries implies that increasingly a compromise/balance will need to be made between targeting global tastes and market segments, while at the same time responding to local tastes and market segments. Decisions will need to be made with regard to new product development or product reformulation to meet the needs of new market segments such as the “bottom of the pyramid” (Prahalad, 2006; Mahajan & Banga, 2006). This, in turn, will result in a need to develop a balance between managers with knowledge and sensitivity to local market conditions and those with greater familiarity with the priorities of senior management and the extent to which the firm aims to integrate operations at different levels of the value chain across regional and global markets. Procedures will also need to be put in place to evaluate performance at the local, regional, and global level and to assess the effectiveness of decisions and strategies.

Increasing expansion of marketing operations and activities outside the developed world into countries and regions with substantially different customer demand characteristics and infrastructure conditions, creates a need to develop strategies tailored specific to these conditions rather than attempting to leverage strategy directly from developed countries. This, in parallel, is best achieved by hiring managers with knowledge of local environmental conditions and unique customer tastes and priorities, rather than attempting to formulate strategy from corporate headquarters. To the extent that expansion into these markets is in the early
stages of development and that customer tastes and the market infrastructure is likely to be changing rapidly, information relating to such changes and other emerging trends is likely to be needed to effectively develop a strategy for these markets. Such information is best collected and interpreted by local managers who are “close to the ground” and more likely to understand this information correctly, rather than managers at corporate headquarters, who may tend to apply their own cultural self referent. Local management can thus play an important role in developing and implementing strategy at the local level, and also provide valuable local input for overall regional or global strategy and policy guidelines.

In some cases, particularly in rural areas in emerging and developing markets, strategy will need to be developed de novo (Arnold & Quelch, 1998; London & Hart, 2004). Firms will need to start from scratch designing new products and building new product development strategies based on the use of local resources, know-how and skills. Rather than marketing products developed in the home markets to other markets, firms may focus on “disruptive innovation,” that is, developing basic functional products at affordable prices to meet consumer needs (Hart & Christensen, 2002). In some cases, these products utilize technologies developed in these markets based on local resources and capabilities, such as is the case with basic functional products which meet consumer demand and offer a product or service to those who would otherwise be unable to afford it and are happy to have a simple rudimentary version of products available to consumers in developed markets.

The growth of global market segments and the emergence of a global consumer culture coupled with the diversity of traditional local consumer tastes implies that a compromise will need to be made between developing products and positioning them relative to a global market segment, and developing or tailoring products and positioning strategies relative to the local market. This implies that unless the firm adopts a focused strategy, targeting a specific or multiple global segments (e.g., women’s cosmetics), it will need to develop an international portfolio consisting of global, regional, and local brands (Douglas et al., 2001). This strategy is typically adopted by most large fast moving consumer goods companies, especially in categories such as food, detergents, and other household products. However, emerging trends toward cultural hybridization and fusion (Pieterse, 1995) suggest that firms, particularly in categories such as food (frozen main dishes), clothing, furnishing, and entertainment, may move toward creating products that combine elements of different cultures, for example, developing Western
clothes inspired by African designs and motifs or dishes that combine Asian with French cuisine.

Such trends suggest that firms will need to look toward developing management, strategy development, and brand teams that combine local know-how and input with experience in working in a variety of local cultural environments to develop managers with a global mind set. This, in turn, suggests the importance of transferring/rotating staff regularly from one local or regional context to another. At the same time, they need to have experience working on teams that develop products and strategy at a global or regional level. Thus, rather than focusing on specialization in a specific region or type of market, managers will have a broad range of exposure to a variety of contexts.

**CONCLUSION**

The growing diversity of markets in which the global MNC is operating – from developed, major, and second-tier emerging markets, transitional and developing economies to within-country heterogeneity – suggests that attempting to develop an integrated marketing strategy for global markets is unlikely to be successful, if not impossible. Rather the firm will need to develop diverse strategies targeted to different countries or groups of countries – for example, integrated strategies for developed countries, country centric strategies for major emerging markets, and prototype strategies for second tier emerging markets, and developing countries. Extensive further research is needed to understand the characteristics of these markets – such as their demand patterns and emerging trends, resource availability, local, regional, and global competition, the nature and evolution of the market infrastructure – in order to develop these diverse strategies effectively.

Equally, effective management of these diverse strategies is likely to prove a major challenge. To date, MNCs from developed countries have tended to focus on developing global integrated strategies across developed country markets. If, however, they are to continue to grow and meet the challenge of firms from emerging market countries, they will need to expand beyond their traditional sphere of operations. This, in turn, will require management and input at the local level in order to be successful. Often these strategies will have little in common. Consequently, coordinating and achieving synergies and efficiencies across markets will be high complex. Nonetheless, understanding how to achieve such synergies is essential if the
firm is to be successful in the rapidly evolving and increasingly complex global marketplace.

REFERENCES


D. INNOVATION AND KNOWLEDGE
TECHNOLOGICAL CLUSTERS AND MULTINATIONAL ENTERPRISE R&D STRATEGY

Ram Mudambi and Tim Swift

ABSTRACT

Economic clusters are global centers of excellence in particular industries or technologies. They consist of interlinked companies, specialized suppliers, support services, and relevant institutional actors in a specific field. Multinational enterprise (MNE) R&D strategy with regard to economic clusters is impacted by two contradictory forces. MNEs locating their R&D activities within economic clusters can benefit by availing of specialized resources and by capturing location-specific tacit knowledge. However, the risks of knowledge leakage can lead to adverse selection whereby clusters attract underperforming firms that have much to gain and little to lose. Further, general disagreement exists on the measurement of performance within economic clusters. We review the literature, assess the evidence, and suggest areas for productive future research.

INTRODUCTION

Firms can compete by striving to access the valuable knowledge required to develop commercially valuable technologies. Much of that knowledge is...
Tacit in nature (Nelson, 1959; Arrow, 1962; Nelson & Winter, 1982; Rosenberg, 1982; Zucker, Darby, & Brewer, 1998). Newly created knowledge is also tacit. This tacit knowledge is known by relatively few people, is idiosyncratic or difficult for broad audiences to understand, and is not easy to share with others (Polanyi, 1962; Zucker, Darby, & Armstrong, 2002).

Tacit knowledge is not transmitted easily; when it is transferable, it is transmitted most effectively in face-to-face settings (Cantwell & Santangelo, 2000; Sorenson, Rivkin, & Fleming, 2006). There is a large body of literature establishing the highly local nature of scientific knowledge flows (Jaffe, Henderson, & Trajtenberg, 1993; Henderson, Jaffe, & Trajtenberg, 1998), underlining the importance of clusters in technology-intensive industries. Thus, firms that utilize high levels of tacit knowledge in their innovation efforts compete by accessing regional knowledge that resides in geographic centers of excellence. These firms create a presence within knowledge-intensive regions so that they can interact with locally embedded R&D subject matter experts (Cantwell & Janne, 1999; Cantwell & Santangelo, 1999). Such regions are relatively abundant in the resources that support R&D that is relevant to the firm’s activities, such as an available supply of specialized knowledge workers.

This line of reasoning underlines the importance of geographic areas – known as “technological clusters” – where R&D work that involves highly tacit knowledge can be performed by colocated R&D scientists. Clusters often represent worldwide centers of excellence in particular industries or technologies. Silicon Valley outside of San Francisco is a well-known technological cluster of software development; Boston’s Route 128 is a well-known biotech cluster, and Southern Germany has a renowned technological cluster for high-precision machinery (Saxenian, 1994; Storper, 1995). Literature suggests many reasons for technological clusters, such as the existence large, incumbent firms in certain regions (Agrawal & Cockburn, 2003), and the colocation of firms that are participating in different but complementary technological fields (Robinson, Rip, & Mangematin, 2007). The most competitive firms seek to place some of their important R&D work inside technological clusters. Firms locate R&D resources in new geographic areas in order to gain access to “locally embedded sectoral specialists” (Cantwell & Santangelo, 1999, p. 120). By interacting with R&D workers that are on the cutting edge of innovation, firms may gain a competitive advantage by applying this new, tacit knowledge in less competitive markets elsewhere.

Clusters provide “the location-specific supply base of technological and knowledge externalities that firms draw upon for their competitiveness”
(Amin & Cohendet, 2004) and clusters vary dramatically in terms of their comparative strengths and weaknesses (Mudambi, 2008). Thus, firms can enhance their competitive advantage by dispersing their creative endeavors, tapping into multiple centers of excellence and coordinating knowledge across geographic space (Lorenzen, 2004). For example, Canon U.S. Life Sciences Inc. is networked into the life sciences cluster along the U.S. eastern seaboard, thousands of miles away from its home-based R&D headquarters in Japan (Uchida, 2008).

Clusters are particularly important for multinational enterprises (MNEs), which by their very nature are network firms. They are able to leverage their networks to effectively tap into a number of local clusters to assimilate and integrate knowledge (Mudambi, 2002; Foss & Pedersen, 2002). However, knowledge traffic is almost always two-way, so that clusters have much to gain from both intentional and unintentional knowledge outflows from MNEs. Thus, MNEs can also serve as conduits between clusters, so that their network knowledge contributes to the health of all the clusters in which they operate. Further, the relative value of knowledge inflows and outflows varies for different MNEs.

In recent years, great progress has been made on the research of clusters. Nonetheless, significant work remains. Construct definition can improve; that is, our research methods can improve by developing common definitions of the key variables used in the field. Scholars have not reached consensus on several critical issues regarding the value and functioning of clusters. Although some research shows that firms exhibit a boost in innovativeness by locating R&D activities within clusters (Baptista & Swann, 1998; Beaudry, 2001), others argue that adverse selection operates within clusters, such that operating within clusters hurts the most innovative firms but benefits the least (Suarez-Villa & Walrod, 1997; Beal & Gimeno, 2001). We have yet to reach agreement on whether changes to firm-level innovation within clusters are due to network ties or agglomeration economies (Bell, 2005).

The purpose of this paper is to address three key topics within the research on technological clusters. We wish to identify “what we think we know.” That is, we will provide a brief overview of extant research on clusters. We will offer our suggestions on “what we need to know,” or potential areas of improvement in our understanding of technological clusters and its importance to the study of international business. Finally, we encourage future researchers not only to evaluate countries and markets when forming international business research questions, but also to emphasize geographic clusters as the unit of analysis. For many companies, this is where the action is.
THEMES WITHIN THE RESEARCH ON CLUSTERS

The Geographic Proximity of Industrial Activity

Economists have observed that industrial activity clusters geographically, and that this clustering activity affects economic performance (Marshall, 1920; Arrow, 1962; Romer, 1986). The more similar the activities of the firms in a cluster, the more likely that relevant (and valuable) knowledge will spill over from one firm to another. At the micro level of the firm, this appears as both a benefit and a cost. The knowledge inflows through learning are valuable to the focal firm while the knowledge outflows are likely to accrue to competitors. However, this is a static view. Over time, the focal firm perceives that while knowledge outflows today may benefit its competitors, this very effect improves its own potential future knowledge inflows. Thus, from the perspective of the cluster as a whole, both the knowledge inflows (benefiting the focal firm) and the knowledge outflows (benefiting its competitors) are positive outcomes. Empirically, sectoral growth in a cluster tends to be higher when concentration of that sector in the cluster is higher. These dynamic effects are known as Marshall–Arrow–Romer (MAR) externalities (Glaeser, Kallal, Sheinkman, & Schleifer, 1992; Henderson, Kuncoro, & Turner, 1995).

This type of analysis has become so mainstream that the U.S. Office of Management and Budget (OMB) has defined “metropolitan statistical areas,” and the U.S. Census Bureau has defined “economic areas.” Each U.S. metropolitan statistical area must have “at least one urbanized area of 50,000 or more inhabitants, with adjacent regions with high levels of sociological and economic integration” (U.S. Census Bureau, 2009). The U.S. Bureau of Economic Analysis (BEA) tracks “economic areas,” which are the “relevant regional markets surrounding metropolitan ... statistical areas” (U.S. Department of Commerce, 2009). Standard definitions of these economic clusters were first defined by the U.S. federal government in 1949 (U.S. Census Bureau, 2009), and economic activity has been tracked using these definitions since that time. This provides an indication of the importance that analysts have placed historically upon geographic clustering of industrial activity.

Krugman (1991) refocused research on economic clusters with his seminal study on economic clusters. He showed that scale economies exist when manufacturing is colocated with demand, and at the same time population clustering depends upon the cost of accessing goods. Thus, consumers and
industry tend to collocate. He found that the density of economic clusters depends upon the cost of transportation, economies of scale, and the relative size of manufacturing in a given economy.

Porter provided in-depth theory and case study evidence suggesting that "geographic, cultural and institutional" proximity (Porter, 1998) enhance the quality of knowledge flows within a cluster. He observed that while the old reasons for clustering, such as the cost of transmitting codified information, have diminished in importance over time, new reasons have emerged, such as the difficulty of transmitting tacit knowledge over longer distances (Porter, 2000). Porter observes that the economic and innovative performance of clusters in the United States varies markedly, and provides evidence that the interaction of different clusters drives regional economic performance (Porter, 2003).

The Geographic Proximity of Knowledge Flows

A common view is that knowledge spillovers increase innovation and productivity growth (Griliches, 1990; Nadiri, 1993), and that much R&D-related knowledge spills over locally (Jaffe, 1986, 1989; Acs, Audretsch, & Feldman, 1992; Jaffe et al., 1993; Zucker et al., 1998). Others have supported this research, finding that R&D activities and the outputs from innovative activities are geographically clustered (Feldman, 1994; Audretsch & Feldman, 1996).

Jaffe et al. (1993) find that patents are two to six times more likely to cite other patents that were filed in a geographically proximate area than patents that were filed farther away. Zucker et al. (1998) support this by observing that the geographic location of biotechnology firms and "star scientists" are highly correlated for the years 1976 to 1989. This provides empirical evidence that basic scientific research provides commercial benefit, but provides no specific insights into knowledge management policies and R&D productivity in pharmaceuticals.

Almeida and Kogut (1999) find that R&D-based knowledge travels locally, and that such knowledge is embedded in local labor networks. Complementary research has showed that knowledge flows not only within an industry, but also between geographically proximate related industries (Jacobs, 1969; Lucas, 1988). Some new technologies can be adapted in multiple industries, creating greater returns to innovation (Scherer, 1984; Bairoch, 1988; Porter, 2003).
AREAS OF CONFLICT

Despite the great progress made on cluster research, much work remains. Scholars disagree on key findings, multiple definitions exist for the same terms, and our performance measures vary greatly from study to study.

What is a Cluster, Anyway?

The formal definition of technological clusters is fairly straightforward. Extant research agrees that a cluster is a group of firms from the same or related industries located in the same or near geographic locations (Becattini, 1990; Brusco, 1990; Harrison, Kelley, & Gant, 1996; Storper & Harrison, 1991; Bell, 2005). However, approaches vary on how to identify technological clusters in an objective way.

Baptista and Swann (1998, 1999) identify a cluster as a region with the relatively highest levels of total employment. Porter (2003) developed a composite measure of clustering based on private sector employment and wages, plus patents created by economic area. Bell (2005) identified the city of Toronto as a cluster, and labeled any firm operating within the city limits as having a presence in the cluster. Lee (2009, p. 1165) asks survey respondents, “In your vicinity (locality) is there a cluster (or group) of firms in your industry (including suppliers and/or users)?” Zucker et al. (1998) identified clusters as those geographic areas surrounding universities that employ star scientists. Aharonson, Baum and Plunket (2008) identified clusters by counting the number of biotechnology firms operating within each postal code in Canada. Baptista and Swann (1999) observe the growth in the cluster itself as a measure of innovativeness of a geographic area.

Finally, some researchers ask, “why do clusters even exist?” Robinson et al. (2007) suggest that effective clusters contain entities that create both science and technological knowledge, and that the combination of these complementary fields of knowledge creates commercially valuable forms of innovation. Agrawal and Cockburn (2003) test the “anchor-tenant hypothesis,” showing that the presence of a large, local, R&D-intensive firm enhances a cluster’s ability to convert local university research into commercially valuable innovation.

When is Geographic Proximity Really Value-Enhancing?

The geographic proximity of research team members is not conducive to all types of innovative work. New technologies created by teams that operated...
using face-to-face interaction have a greater chance of successful commercialization (Almeida & Kogut, 1997; Agrawal, 2000; Jensen & Thursby, 2001; Mowery & Ziedonis, 2001). Gittelman (2007) finds that geographically proximate R&D teams generate more commercially valuable innovations, while geographically dispersed R&D teams generate more high-impact scientific knowledge.

Close proximity among R&D team members allows for close personal interaction, which fosters the creation and transfer of tacit knowledge. Increasing distance reduces the frequency of face-to-face interaction between team members. For example, prior research finds that communication between engineers falls dramatically if the work locations of the engineers are greater than 30 m apart (Allen, 1977). Further, long-distance communication often compels knowledge workers to rely on other modes of communication, such as email and telephone conversations, which rely more heavily on codified forms of knowledge. However, there is also evidence that these deleterious effects of geographical dispersion can be minimized through the development of teamwork and socialization between members of different units within the firm (Mudambi, Mudambi, & Navarra, 2007).

Conversely, the labor market for science workers is geographically dispersed. Graduate students relocate for tenure-track positions in new cities, but maintain research relationships with colleagues at their alma maters. Prior research asserts that the social networks of scientists are geographically dispersed (Merton, 1973; Allison & Long, 1987; Gittelman, 2007). Thus, geographically dispersed teams generally engage in high-impact science, which has limited near-term commercial value (Gittelman, 2007).

Does Cluster Presence Really Enhance Firm Innovation?

As discussed above, literature has long suggested that the agglomeration of industry conveys many benefits. Taken collectively, extant evidence does not demonstrate a clear benefit from participating in a cluster (Lee, 2009). Research has shown an increase in innovating patenting activity for firms within a cluster (Baptista & Swann, 1998; Beaudry, 2001). Others do not find any increase in innovation (Suarez-Villa & Walrod, 1997; Beal & Gimeno, 2001).

There are two potential reasons that clusters may not be related to innovation. First, any observed increase in knowledge spillovers may be due to formal market mechanisms such as contracts or equity ownership between firms, and not any special effects of geographic proximity (Zucker et al., 1998; Geroski, 1995). In addition, this research suggests that
the “best” knowledge that flows within clusters is protected by legal mechanisms; only the least valuable knowledge is freely available. Others argue that clustering increases R&D-based competition for resources, suppressing innovation (Beal & Gimeno, 2001). Pouder and St. John (1996) observe that a burst in innovative activity within clusters is often followed by spectacular collapse. They attribute this to the development of core rigidities (Leonard-Barton, 1992) within these clusters that reduce firms’ ability to explore for new ideas and continue to innovate.

Second, and perhaps most importantly, many researchers suggest that adverse selection can operate within clusters (Oakey & Cooper, 1989; Shaver & Flyer, 2000a, 2000b; Cantwell & Santangelo, 2002; Fosfuri & Ronde, 2004). If clustering increases knowledge spillovers, intuitively we see that the most innovative firms will experience a “net loss” of knowledge (because they spill more knowledge than they can gain) while the least innovative firms benefit, gaining more knowledge than they disclose.

Finally, others argue that firms within clusters are also simultaneously participating in global information networks. Thus, it is difficult to tease apart the benefits of the local and global network participation (Angel & Engstrom, 1995; Zeller, 2001). Recent research finds that knowledge flows are quite strong between an inventor’s prior location and the location to which he or she moves, suggesting that social relationships and “coinvention networks” play an important role in knowledge flows between clusters (Agrawal, Cockburn, & McHale, 2006; Breschi & Lissoni, 2009).

**How Should We Measure Cluster Influence?**

We do not agree on how to measure the impact that clusters have on firm’s innovative efforts. Some researchers have observed that firms that operate within clusters grow faster than firms outside the cluster (Henderson, 1983; Baptista & Swann, 1998; Glaeser et al., 1992). Other researchers observe the number of patents firms within clusters create as a measure of innovative performance (Harrison et al., 1996; Cantwell & Janne, 1999; Cantwell & Santangelo, 2000; Cantwell & Piscitello, 2002). Baptista and Swann (1998) measure the actual number of innovations the firm has produced, whether patented or not. Lee (2009) evaluates whether firms that operate within a cluster have higher R&D intensity, while others measure the adoption of new technologies (Breschi & Lissoni, 2009).
Benefiting the MNE vs. Benefiting the Local Subsidiary

The MNE’s local presence in a cluster is typically a subsidiary. The MNE subsidiary serves as its pod to access, transfer, integrate, and leverage localized cluster knowledge (Foss & Pedersen, 2002). However, there is evidence that the struggle for control of knowledge assets can increase the level of intrafirm tension in MNEs (Asakawa, 2001). Therefore there are conflicting views with regard to the MNE’s knowledge strategy at the subsidiary level. There is evidence that accessing cluster knowledge requires the subsidiary to embed itself in local knowledge networks (Andersson, Forsgren, & Holm, 2002). There is also evidence that subsidiary control of valuable local knowledge assets can reduce the ability of headquarters to control and leverage the knowledge (Mudambi & Navarra, 2004). Reconciling these two bodies of evidence implies that MNE subsidiary strategy must be nuanced to balance countervailing forces. Subsidiaries need to be given enough freedom to enter local knowledge networks; headquarters needs to maintain enough control to ensure that they remain firmly anchored within the MNE internal firm network. This “dual-network” view of the MNE subsidiary is recognized as critical to innovation success in MNEs. However, successful implementation of a strategy to lead to this outcome has proved to be a challenge for most MNEs (Birkinshaw & Pedersen, 2008).

ASSESSMENT OF THE EVIDENCE: PRIVATE GOOD VS. PUBLIC GOOD
ASPECTS OF KNOWLEDGE

Our preceding review of the literature highlights two major issues. First is the public policy question; we must do more to determine the effect of cluster participation on the average firm, and the most innovative firms. Does cluster presence enhance innovation and productivity? Is the impact different between average firms and the best firms? The second issue is the strategic management question; we do not adequately understand how the presence of clusters should inform firm strategy. Under what conditions should a firm choose to locate its innovative activities within a cluster?

Much of the recent empirical literature in economics and economic geography focuses on the first, public policy issue. Scholars have made great
progress in understanding and identifying MAR externalities, or *intrasectoral* spillovers (Marshall, 1920; Arrow, 1962; Romer, 1986; Glaeser et al., 1992; Henderson et al., 1995) and Jacobian externalities, or *intersectoral* spillovers (Jacobs, 1969); they have presented widespread evidence that these phenomena are the main drivers of cluster performance.

The strategic management literature is split between the “market for lemons” or adverse selection argument (e.g., Shaver & Flyer, 2000a) that holds that only inferior firms locate in clusters, and the more traditional Porter argument whereby cluster location yields greater benefits than costs. We can suggest a resolution whereby the deciding factor involves considering the type of industry (e.g., oligopolistic vs. competitive).

The geographically concentrated nature of inputs to the innovative process (e.g., labor and knowledge) within clusters should attract firms. However, the incentive to the firm for locating its innovative activities within a cluster depends upon the structure of the industry in which the firm competes (McCann & Mudambi, 2005). In a competitive market structure, there are a relatively high number of smaller firms; each of these firms has relatively small market share and profits. As such, these firms probably have little to lose from unintentional knowledge outflows and more to gain from inflows stemming from a strong clustered location. The public-good aspect of knowledge would appear to dominate here, with the local knowledge outflows being viewed as generally positive both for the firms themselves and for the local region (Jaffe et al., 1993; Saxenian, 1994).

In an oligopolistic industrial structure, relatively fewer players possess relatively larger shares of valuable knowledge. Thus, leakage of knowledge from one firm to a competitor can have significant impacts on the balance of power within a cluster comprised of fewer, larger firms. If the clustering of oligopolistic firms appears to jeopardize their proprietary knowledge assets by exposing themselves to the possibility of unintentional outward knowledge spillovers, such firms will decide not to locate in clusters, unless they can find a way of avoiding unintentional knowledge outflows.

Thus, prior to selecting locations for conducting its R&D activities, firms must consider the structure of the markets within which they compete, and the composition of cluster. Larger, R&D-intensive firms colocating in technological clusters with other larger competitors can engage in a high-stake games of knowledge exchange that can damage the firm’s competitive position. Smaller firms engaging in more competitive markets are more likely to engage in the value-enhancing knowledge sharing that can take place within technological clusters (McCann & Mudambi, 2005).
NEXT STEPS FOR INTERNATIONAL BUSINESS AND MANAGEMENT RESEARCHERS

Under what conditions is locating within a technological cluster beneficial to the firm? Are some clusters better than others? How can we measure the relative attractiveness of clusters? How should locating within the right cluster, under the right conditions, influence firm performance? What advantages accrue to MNEs that locate within clusters? These are a few avenues along which we can push the frontiers of research and provide practical advice to international business practitioners.

First, researchers need better construction definition. Valuable progress in strategic management research was spawned by Porter’s *Competitive Strategy* (1980). By firmly rooting his Five Forces model in industrial organization economics, Porter provided strategic management researchers a consistent approach to developing testable hypotheses using reliable empirical methods. In the same way that rich theoretical frameworks have advanced management research in the past, research on technological clusters can advance by developing common definitions of clusters and cluster performance, and robust contingency theories that explain the conditions under which cluster location can aid in creating valuable knowledge.

Second, studies can utilize multiple measures of performance when evaluating cluster impacts. Since disparate measures of performance have been used in the literature to evaluate cluster innovativeness, we lack a clear picture of which facets of economic geography impact which dimensions of firm performance. New studies can observe the multivariate relationships between location variables, firm profitability, firm value, knowledge creation, firm growth, and innovation.

Third, longitudinal studies can shed light on whether the firm’s innovative performance changes after the firm locates in a technological cluster. While several scholars have asserted that adverse selection may operate within clusters (Oakey & Cooper, 1989; Shaver & Flyer, 2000a, 2000b; Cantwell & Santangelo, 2002; Fosfuri & Ronde, 2004), the empirical evidence is not conclusive since the existing studies have not tracked firms over time. New studies can observe firm performance before and after cluster entry, and evaluate whether the firm’s relative knowledge endowment prior to entering the cluster influences the impact that cluster participation has on the firm’s innovative performance.

Finally and perhaps most importantly, more can be done to inform international business strategy. Seminal studies have led to the current view of the MNE as a global network of strategic business units (SBUs)
(Nohria & Ghoshal, 1994), each with unique roles such as innovators, implementers and specialists (Gupta & Govindarajan, 1991). Innovator SBUs or competence-creating subsidiaries discover and integrate new knowledge (Gupta & Govindarajan, 1991), often creating new competencies for the MNE as a whole (Cantwell & Mudambi, 2005). Clearly, such SBUs stand to benefit most from participation in the right technological clusters. However, within the international business literature, the industrial cluster is treated rather simplistically as a source of knowledge (Kuemmerle, 1999), so that important questions remain. First, what corporate structures provide MNE subsidiaries the best chance of successful participation within the cluster? Second, should MNEs collocate with its large competitors and risk losing competitively valuable knowledge? Third, how can MNEs identify new clusters that are creating the nascent knowledge that will be available in the future and avoid becoming entrapped within “older” clusters that are suffering technological lock-in (Leonard-Barton, 1992; Narula, 2001; Pouder & St. John, 1996)?

**CONCLUDING REMARKS: MNES AND TECHNOLOGY CLUSTERS**

The global innovation system is composed of knowledge processes that are spatially confined and that can be accessed only through local presence (what has been called “buzz”) and processes that involve transferring such knowledge over distances (through what have been called pipelines or conduits) (Bathelt, Malmberg, & Maskell, 2004; Mudambi, 2002). MNEs are a critical part of the global innovation system since they incorporate both knowledge processes. MNE subsidiaries are embedded within and function as integral parts of technology clusters as they access and filter knowledge and generate spillovers. MNEs’ internal networks are de facto global pipelines and knowledge flows between MNE units are a significant portion of pipeline content.

This approach recognizes the symbiotic nature of innovation in the cluster and in the multinational firm. Thus, the internal innovation system of the multinational and the cluster system of innovation each affect the evolution of the other. The MNE knowledge network can therefore be leveraged to generate two unique advantages: (1) transfer – the use of knowledge created anywhere in the network at all other nodes of the network, and (2) integration – the synthesis of knowledge flows from the parent, other subsidiaries, and from its host location (McCann & Mudambi, 2005).
It becomes apparent that the MNE’s knowledge strategy (that underpins its competitive advantage) is based on optimizing the knowledge transfer and integration functions. These functions are determined, in large part, by the “portfolio” of clusters in which the MNE chooses to locate its knowledge sourcing operations, through subsidiaries or other entry vehicles. It is well known that MNEs operating within each industry can be hierarchically differentiated into leaders and laggards (Cantwell, 2009). There is accumulating evidence that technology clusters in particular industries are also hierarchical, with the higher level ones being serviced by those at a lower level (Cantwell & Janne, 1999). Thus, the optimal portfolio of cluster locations chosen by an MNE is likely to differ depending on firm characteristics.

This analysis suggests several important avenues for future research. Technology clusters themselves evolve over time. Much is yet unknown about this evolutionary process. Some clusters persist for long periods of time (Lorenzen, 2005), renewing themselves as they survive the life cycles of several industries. Example include the clusters of radio producers in the United States that shifted to television (Klepper, 2007) and the accordion cluster in Marche that incorporated electronics into its instruments as it renewed itself in this industry. Other clusters, like the Boston Route 128 computer and semiconductor cluster, are eclipsed even as their main industries continue to grow (Saxenian, 1994). This implies that the MNE’s strategy with regard to cluster location will evolve over time. In fact, the clusters in the MNE’s portfolio are likely to be impacted by its location decisions, so that firms and clusters coevolve. Little is known about the nature of this coevolution as it has received little attention in the literature.

Research on technological clusters is valuable. It provides value for researchers seeking to develop a better understanding of strategy and IB theory, for public policy makers seeking to maximize economic performance, and for managers seeking to capture lightning in a bottle, and convert cutting edge knowledge into commercially valuable innovation. All of these diverse constituencies would benefit from a better understanding of MNEs’ strategies with regard to technology clusters.

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MANAGEMENT INNOVATION AND THE MULTINATIONAL CORPORATION

Michael J. Mol and Julian Birkinshaw

ABSTRACT

This paper relates management innovation to multinational corporations (MNCs). We argue that MNCs play two key roles in implementing management innovations. First, they can engage in management innovating by inventing and implementing new management practices. We show that while MNCs have been involved in management innovating, few of their management innovations are specifically international in nature. Second, they can be involved in the diffusion of management innovations, including the transfer of new management practices to other countries. There is more evidence for this role. We propose that international business research should attempt to incorporate management innovation into its body of research themes.

INTRODUCTION

A new practice and research agenda is forming around the topic of management innovation (Birkinshaw, Hamel, & Mol, 2008; Birkinshaw & Mol, 2006; Damanpour, Walker, & Avellaneda, 2009; Hamel, 2007).
Following Birkinshaw et al. (2008), we define management innovation as the invention and implementation of a new management practice, process, structure or technique that is intended to further organizational goals. We acknowledge that this emerging literature has important roots in and connections with earlier literatures, especially those concerned with administrative innovation, management fashion, management models, organizational change, and technological innovation (see, for instance, Abrahamson, 1991, 1996; Barley & Kunda, 1992; Damanpour, 1987; Guillen, 1994; Henderson & Clark, 1990; Kimberly & Evanisko, 1981; Teece, 1980; Van de Ven & Poole, 1995). We will not detail those connections here but have done so elsewhere (Birkinshaw et al., 2008).

Our aim here is to start exploring the relationship between management innovation and the multinational corporation (MNC), especially in terms of how MNCs may be involved in both creating and diffusing management innovations. There is a relatively small literature that concerns itself with management innovation and the MNC. In particular, some work suggests that the multinational firm can act as a vehicle for diffusing specific management innovations across the globe (Czarniawska & Sevón, 2005; Kogut & Parkinson, 1993; Lillrank, 1995; Strang & Kim, 2005). This diffusion process is one area we will touch upon in this paper, although we will seek to generalize beyond individual innovations to discuss the wider phenomenon of how management innovations could diffuse in MNCs. In this paper, we use the term “diffusion” exclusively when discussing how management innovations are taken up by a population of organizations, none of which have invented these innovations themselves.

Our other area of concern is how multinational firms invent and then implement management innovations. Again, there is a small literature that discusses what might be seen as management innovations specific to the MNC of which Bartlett and Ghoshal’s (1989) work on the transnational corporation (TNC) is perhaps the best known example. They described the emergence of an idealized type of MNC that was able to simultaneously deliver on the three imperatives of global integration, local responsiveness, and worldwide learning. While they acknowledged that no company fully matched this ideal, they were able to identify certain companies, such as Kao, Ericsson, and GE, that exhibited important features of the “transnational solution,” and many of these features were subsequently diffused to some other MNCs. When discussing how innovations are created somewhere inside MNCs and then implemented by other parts of the MNC, we will not use the word diffusion but will instead refer to a transfer.
But to the best of our knowledge, nobody has addressed the following two questions critical to the understanding of the relationship between management innovation and the MNC. (1) What forms do implementations of management innovations take inside multinational firms? (2) Do we see any evidence that multinational firms are more likely to engage in management innovation than domestic firms? These are very relevant questions both to the world of academia and to the world of practice. For academics answers to these questions would contribute to the development of the theory of the multinational firm. It has been widely recognized that some of the existing theory in IB/IM has slowly become outdated because of new ways of organizing and because organizations shift their focus from competing on costs toward competing on innovativeness (see, for instance, the recent special issue on innovation in international business theory in *Journal of International Business Studies*). Beyond this conceptual issue, insights on management innovation inside MNCs would add to our empirical knowledge base on the state and evolution of MNCs. For managers of multinational firms, answers to these questions would be a helpful guide in their efforts at creating, adopting, and implementing new practices, processes, and structures. This could in turn positively affect their ability to compete in an era that increasingly requires multiple sources of competitive advantage and sources that are difficult to complicate, of which management innovation is a good example (Birkinshaw et al., 2008).

In this paper, we want to start tackling these issues by investigating how management innovation might be different in MNCs. Four sections follow this introduction. We start by looking at how MNCs have created management innovations, arguing that existing literature suggests that most of the well-known historical management innovations are not specifically associated with the cross-border aspects of MNCs but that there is substantial evidence of creation of management innovations and their subsequent transfer by major MNCs like Toyota, GE, and Procter and Gamble. Next, we look at the MNC as a vehicle for diffusing management innovations across borders, arguing that MNCs typically have been the primary driver of cross-border diffusion. We then create a classification that details the six possible routes which implementation of management innovation inside an MNC may take. This classification operates along two dimensions – creation versus diffusion and the geography of the implementation (home, local, or global). We present some exploratory empirical evidence on the implementation of management innovations by a large number of firms in the UK, which appears to suggest that MNCs are more active implementers of management innovations. Third, we present a research agenda on
management innovation and the MNC, detailing routes which researchers could take to further theorize around or empirically investigate this topic. Finally, we present some conclusions.

**MNCS AS MANAGEMENT INNOVATORS**

Conceptually, there are broadly two possible explanations why management innovating, the process of creating and implementing management innovations, might be different in multinational firms than in purely domestic firms. One explanation draws on the notion that multinational firms need to have some type of firm-specific advantage to overcome their “liability of foreignness” (Dunning, 1988; Hymer, 1976; Kostova & Zaheer, 1999). The other explanation argues that some types of innovation are either only possible in multinational firms or are substantially more effective in multinational firms, and that the multinational structure itself can even be seen as a management innovation. In discussing this further, we need to make an important distinction regarding the newness of management innovations. The types of innovations we discuss in this section are new to the state of the art or even new to the world innovations, while the next section discusses types that are new to the firm innovations.

What are these specific advantages? Probably the central question that has occupied the field of IB is “why do multinational firms exist” (Buckley & Casson, 1976; Dunning, 1988). This question is a variation on the theme “why do firms exist,” which is one of the core questions in strategic management and industrial organization. IB adds to that strategy discussion the notion that a domestic firm, with its knowledge of the local market, existing relations, reputation, and other intangible benefits, must surely be in a stronger position than a foreign firm ceteris paribus. In other words, foreign firms, which are by definition “multinational,” face some disadvantages that have come to be known as the liability of foreignness (Kostova & Zaheer, 1999). So if the liability of foreignness exists, then foreign firms that are active in another country must, by definition, have found some route to negate or overcome that liability.

It is argued by many scholars (e.g., Dunning, 1988) that the route around the liability of foreignness is found in firm- or ownership-specific advantages. If a foreign firm possesses advantages that domestic firms do not possess, for instance, a global brand name, intellectual property, or routines, it may successfully enter and operate in a host country despite the liabilities arising in other aspects of its operations. We argue that innovation, and
specifically management innovating, may be a source of such advantages. Management innovation is typically deeply rooted in an organization’s systems and knowledge base. Management innovating is a process surrounded by much ambiguity, and there is a great need for legitimizing new innovations, which is why there tends to be relatively much external involvement in this process (Birkinshaw et al., 2008). Some management innovations, examples being Toyota’s lean production or Scandinavian participative management, are also significantly enabled by cultural and institutional factors in the MNCs’ respective home countries and thus by definition difficult to replicate let alone create by local firms in other countries.

There is considerable anecdotal evidence to support the notion that management innovating provides a form of competitive advantage for firms, perhaps most classically described in Chandler’s (1962) study of the invention and implementation of the multidivisional form or M-form inside General Motors. Chandler argues that the M-form provided GM with substantial firepower in its battle with Ford Motor Company over dominance in the U.S. car industry. Following the M-form, GM managed to effectively use other innovations such as brand management. Indeed, GM later expanded the principles of the divisional form to create an international division. This suggests that an MNC that comes up with a management innovation, perhaps in its home country or through its multinational network, can transfer that innovation to the host countries in which it operates. In these host countries, it can then use the innovation to outcompete its domestic rivals, which are unfamiliar with the innovation or do not understand well enough how it creates competitive advantage (because of causal ambiguity). Hence, management innovation improves the odds of survival in a foreign environment for multinational firms.

A second explanation for why management innovating may be different in MNCs is that being a multinational could itself be a fertile breeding ground for management innovation. In other words, because MNCs operate in a peculiar context (being firms with cross-border activities), only they can come up with the kinds of management innovations specific to that context. The earlier example of the TNC (see Bartlett & Ghoshal, 1989) is a case in point. The need to develop such a sophisticated organizational model only really arises when a company is straddling many different geographical and cultural boundaries. Percy Barnevik, the well-known former CEO of ABB, often claimed that by building a multidimensional matrix structure (broadly built on the “transnational” principles) it created an advantage that was hard for others to copy. Parenthetically, this complexity was both a source of advantage in good times and a millstone around the company’s neck in bad times.
Similar arguments may be made for other innovations specific to the multinational context such as the practice of transfer pricing, which oil companies took up as far back as the 1930s; or the global virtual team, as developed by a number of companies including BP in the 1990s; and global account management, with companies such as Citibank and Hewlett Packard among the innovators. And currently, there are arguably experiments under way in the area of offshoring, which will help redefine firms’ abilities to coordinate activities without being colocated and create competitiveness by combining the efforts undertaken in multiple locations. What these innovations have in common is that they are all ways of improving the effectiveness of a firm that are by definition only available to multinational firms.

Promising as this second explanation may sound, the reality is that there is actually rather little evidence that it underlies large numbers of management innovations or indeed very important innovations in the wider scheme of things. In our book *Giant Steps in Management* (Mol & Birkinshaw, 2008) we explored 50 key historical management innovations. Interestingly, there is not a single management innovation on this list that is specific to the context of being a multinational firm! By contrast, many of these 50 innovations are in line with the first explanation, and have proven to be routes that allowed foreign firms to overcome the liability of foreignness. Other lists, such as that provided by Kossek (1987) for management innovations in human resources or Georgantzias and Shapiro (1993) for innovations in operations management, do not suggest differently.

Looking at our list (Mol & Birkinshaw, 2008), we, for instance, note that lean manufacturing and total quality management have clearly been important stepping stones in the successful internationalization of Toyota and other Japanese manufacturing firms, as have the use by many multinationals of discounted cash flow and return on investment techniques in assessing FDI prospects. The application of pay-for-performance, assessment centers, and management education in recruiting and developing talented foreign employees, the use of brand management by Procter and Gamble, and scenario planning by Shell have also served as distinct examples of firm-specific advantages that have been instrumental in mitigating the liability of foreignness. All these innovations started at home and were then transferred elsewhere, and none of them are specifically connected to being a multinational firm. But rather than repeating each of these invention processes in depth here, we simply conclude that the more proficient and impactful occurrence of management innovation in MNCs has been around innovations that were first implemented in the MNCs’ home
base and are not multinational in nature. This of course does not in any sense imply that these efforts were trivial or unproblematic. Both the process of creating these management innovations as well as their subsequent transfer to foreign subsidiaries in fact pose significant managerial problems. While the evolving management innovation literature describes the challenges related to management innovating, there is also an extensive literature on knowledge transfer in MNCs, which equally documents how difficult it can be to transfer practices from one location to the next (e.g., Szulanski, 1996).

Apart from management innovating taking place inside MNCs due to the fact that MNCs are “different” from local firms, management innovating can also take place inside foreign subsidiaries of MNCs, in a similar vein to local firms. In other words, like any local firm, a foreign subsidiary or regional headquarters of an MNC may create management innovations, which will be partly or even largely inspired by the local environment the firm operates in. As noted by Devinney, Midgely, and Venaik (2005), it is important to recognize that not only do MNCs compete against other MNCs via their portfolio of subsidiaries, they also compete against combinations of local firms directly through their individual subsidiaries. The literature on subsidiary management, which has developed especially over the past 15 years, contains examples of more and less successful local efforts at management innovating. It is probably true that generally speaking these innovations have been less impactful than home-grown innovations but ultimately that is an empirical question.

To conclude, there are good reasons why MNCs might engage in management innovating and we have been able to distinguish between three types of management innovations inside MNCs. There has been a significant amount of management innovation inside the home base. These home-grown management innovations are often transferred abroad and can add to the competitive advantage of MNCs vis-à-vis local competitors. There are also examples of management innovations created by the local subsidiaries or regional headquarters of MNCs. Innovations specific to their status as a multinational firm, and occurring at the global level, on the other hand, appear to have been fairly rare. We will revisit this point later.

**MNCS AND THE DIFFUSION OF MANAGEMENT INNOVATIONS**

This brings us to the second role played by multinationals in the management innovation process, that of diffusion. In this paper, diffusion
involves management innovations created by other firms but taken up by the focal MNC, and then possibly to different geographical areas of the world. In other words, we can best understand diffusion by looking at a specific MNC as one of many organizations in a wider population, some proportion of which will take up a given innovation. Diffusion is the issue with which the literature around management fashion (Abrahamson, 1991, 1996) primarily concerns itself.

The diffusion of management innovation often involves modification (Ansari, Fiss, & Zajac, 2010), and in the case of diffusion by MNCs there are two separate steps in this modification process. First, the external innovation (fashion) is modified to suit the conditions of the firm and its environment. Second, as the MNC internally transfers the innovation to other countries it is modified again to suit the needs of the local units it is transferred to. GM may, for instance, take up Toyota's lean manufacturing practices in a modified form and then transfer them to its German Opel operations, which involves further modification. Note that it is quite possible that a firm modifies an outside innovation to such an extent that what actually emerges internally is a new innovation in its own right. In fact, while we conceptually separate creation and diffusion in this paper along with how the literature discusses it (Birkinshaw et al., 2008; Ansari et al., 2010), there are likely to be some gray areas with innovations which are diffused but also involve elements of creation.

As was the case for creation, we could see diffusion operating at three levels. One is where an MNC takes up “global” innovations, which affect its operations throughout all the regions of the world it operates in. A specific MNC may, for instance, have decided to participate in the diffusion of the Transnational solution of Bartlett and Ghoshal (1989). A second type is where an innovation is initially taken up at home and then transferred elsewhere, for instance, if another U.S. MNC decided to follow in the footsteps of Motorola and GE by adopting the principle of Six Sigma, and encourage or even mandated its national or regional subsidiaries elsewhere to take up that practice. Finally, a third type of diffusion can come from a foreign subsidiary taking up a management practice it has learned locally and which perhaps has proven to be effective in its host country. This practice could then also diffuse to other subsidiaries, more likely so if the subsidiary is well-connected to other parts of the firm and is run in an entrepreneurial fashion.

A major question this discussion raises is what it actually means when an MNC or its foreign subsidiary implements a management innovation. So far we have distinguished on the one hand between the creation and diffusion of
management innovations, and on the other between innovations implemented at home (and then possibly transferred elsewhere), globally (and thus applicable across the MNC), or locally (and then possibly transferred elsewhere). In other words, we have one dimension that distinguishes between innovations that are new to the state of the art (or even the world) and innovations “merely” new to the firm. And we have another dimension that distinguishes management innovation based on their geographical source, which can be the home or host country, or a truly global source (where the innovation is MNC specific and implemented globally). Table 1 summarizes the six options that logically follow from juxtaposing these two dimensions. We will discuss ways of making sense of these different options empirically in more detail below.

**EMPIRICAL EVIDENCE ON IMPLEMENTATION**

Now we will focus on the second question, whether subsidiaries of foreign multinational firms are more likely to implement management innovation. In doing so, we will initially take a highly empirical approach, where we let the data speak for themselves, before providing more detailed conceptual discussion in the next section, when we will also attempt to more closely integrate the answers to the two research questions we are seeking to answer in this paper. But even though our approach is empirical, it is guided by the broad expectation outlined above that subsidiaries of foreign MNCs are likely to be more actively engaged in management innovation.

In a recently published study (Mol & Birkinshaw, 2009) we used the third version of UK Innovation Survey, which is a national survey of firm-level innovation now conducted every other year as part of the Europe-wide Community Innovation Survey (CIS), to investigate the antecedents and performance consequences of management innovation. Here we will build

<table>
<thead>
<tr>
<th>Source Type of Innovation</th>
<th>Home (Originating in Home Country)</th>
<th>Global (Specific to Being an MNC)</th>
<th>Local (Originating in Host Country)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation (new to the state of the art or the world)</td>
<td>Home-grown creation</td>
<td>Global creation</td>
<td>Local creation</td>
</tr>
<tr>
<td>Diffusion (new to the organization)</td>
<td>Home-based adoption</td>
<td>Global adoption</td>
<td>Local adoption</td>
</tr>
</tbody>
</table>

Table 1. Different Types of Implementation of Management Innovation Inside an MNC and Its Subsidiaries.
upon these data to try and explore whether UK subsidiaries of foreign MNCs are more likely to implement management innovations than local firms. The aim is to create some empirical understanding of how management innovation and the MNC are connected at present. Note that by definition an implementation could be in any of the six boxes above, since we are comparing UK subsidiaries of foreign firms with a set of UK firms, some of which will themselves be MNCs, and have no further information about whether the innovations concerned are just new to the firm or also new to the state of the art or even the universe. Finally, this is very much intended as an exploratory analysis.

The CIS3 data were gathered in 2001 and cover the 1998–2000 period. The UK survey is administered by the Office for National Statistics (ONS) and commissioned by the Department of Trade and Industry. Stockdale (2002) provides an overview of the methodology and basic descriptive findings of the survey. The UK survey was sent to 19,602 firms, selected through a stratified sample, of which 8,172 (41.7%) responded. More than 60 articles have been published using the CIS (e.g., Laursen & Salter, 2006). The survey was administered by the ONS and was the third in the series. The OECD’s Oslo manual provides the basis for the question in CIS3, which adds to the comparability of findings across industries and countries. The CIS sample includes manufacturing, construction, and services firms. Respondents included many Managing Directors, Chief Financial Officers, and heads of Research and Development.

One question in the CIS3 survey tackles “wider innovation,” which stands out from the product and process innovation. Here we report three items from the CIS3. Respondents were asked “did your enterprise make major changes in the following areas of business structure and practices during the period 1998–2000? And how far did business performance improve as a result? (a) Implementation of advanced management techniques within your firm, e.g., knowledge management, quality circles; (b) implementation of new or significantly changed organizational structures, e.g., investors in people, diversification; and (c) changing significantly your firm’s marketing concepts/strategies, e.g., marketing methods.” Firms that acknowledge using an item are coded with a 1, while those that do not are coded with 0. From the Annual Respondents Database (ARD) that ONS collects separately, and on an annual basis, we then took a measure that codes subsidiaries of foreign multinationals as 1, and all other firms as 0. We use these measures in our analysis below.

We present the findings in the tables below. Table 2 indicates that multinational firms score higher than domestic firms on each of the three
areas of management innovation. A subsequent ANOVA test showed that these differences are all highly statistically significant (at the 1% level). The absolute difference between multinationals and domestic firms is largest for the organization measure (26%), while it is smallest for the marketing measure (14.7%). In the final column, we have calculated the expected number of areas of management innovation for domestic and multinational firms. This difference is highly significant (1%) as well.

Table 3 contains some bivariate correlations between the three areas of management innovation and being a multinational. It turns out that each of these correlations is significant at 1%. This table not only confirms the analysis presented in Table 2 but also shows that the various types of management innovation are strongly positively correlated to one another. In other words, firms that engage in marketing-based innovations are also more likely to engage in innovations pertaining to organization or management and vice versa. Such correlations among multiple variables obviously call for a multivariate type of analysis. Preliminary multivariate analyses seem to suggest that the effects we present here still hold, even when we start controlling for factors like firm size, industry, and other types of factors.

**Table 2.** Percentage of Firms that has Implemented a Management Innovation in a Specific Area and Expected Number of Areas of Management Innovation in which a Firm has been Active (Domestic, Multinational, and Weighted Average for all Firms).

<table>
<thead>
<tr>
<th></th>
<th>Management (%)</th>
<th>Organization (%)</th>
<th>Marketing (%)</th>
<th>No. of Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic</td>
<td>33.6</td>
<td>36.8</td>
<td>44.4</td>
<td>1.15</td>
</tr>
<tr>
<td>Multinational</td>
<td>54.9</td>
<td>62.8</td>
<td>59.1</td>
<td>1.77</td>
</tr>
<tr>
<td>All</td>
<td>35.2</td>
<td>38.9</td>
<td>45.5</td>
<td>1.20</td>
</tr>
</tbody>
</table>

* N = 7,286.

**Table 3.** Correlations between Various Areas of Management Innovation and Being a Multinational.

<table>
<thead>
<tr>
<th></th>
<th>Management</th>
<th>Organization</th>
<th>Marketing</th>
<th>Multinational</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Organization</td>
<td>0.63</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marketing</td>
<td>0.57</td>
<td>0.59</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Multinational</td>
<td>0.12</td>
<td>0.14</td>
<td>0.08</td>
<td>1</td>
</tr>
</tbody>
</table>

* N = 7,286.
innovation. But clearly we would need to conduct further analyses to prove that point.

This brief empirical exploration seems to suggest that the UK subsidiaries of foreign multinationals are more likely to implement management innovations than are local firms, which raises some interesting implications and questions we will discuss below.

TOWARD A MANAGEMENT INNOVATION RESEARCH AGENDA IN IB

The management innovation research agenda is still taking shape and research which connects management innovation and the MNC is quite limited. In this paper, we have presented two broad research questions: (1) What forms do implementations of management innovations take inside multinational firms? (2) Do we see any evidence that multinational firms are more likely to engage in management innovation than domestic firms? We presented a framework to think about the first of these questions and some empirical evidence to answer the second question.

The questions are interrelated in intricate ways. Most importantly, we believe there is an overriding argument that can help us understand both questions, which is to do with how MNCs create competitive advantage. The creation of management innovation is expected to be a substantial source of competitive advantage (Chandler, 1962; Gruber & Niles, 1972; Hamel, 2006), although evidence to substantiate this is still relatively limited, at least when we consider management innovation as a phenomenon, rather than simply an individual management innovation (Mol & Birkinshaw, 2009). Likewise, MNCs operating abroad need to create sources of competitive advantage, which local firms do not possess, in order to overcome their liability of foreignness.

This suggests two implications. First, it suggests, as we were able to observe empirically above, that levels of management innovation may be higher among subsidiaries of foreign MNCs than they are among local firms, perhaps even those local firms which themselves operate as MNCs abroad. In terms of the framework we presented in Table 1, subsidiaries of foreign MNCs can benefit from two or perhaps even three sources of management innovation, in the form of home-grown and local innovations (and arguably global innovations), unlike local competitors, who are limited to innovations created or diffused locally. Thus there are differences on the
horizontal dimension of our framework. Second, it would also suggest that in the mix between creation and diffusion, i.e., the vertical dimension of the framework, MNCs are perhaps more likely to be at the heart of creating new management innovations. Newly created innovations are more likely to lead to competitive advantage than innovations adopted from elsewhere because of possible first mover advantages on the part of the creator, and because management innovations are typically hard to copy as argued elsewhere (Hamel, 2006; Mol & Birkinshaw, 2009).

We would now like to submit a number of interesting questions for future research on management innovation and the MNC, along with some indications of how researchers might conceptualize and empirically investigate these questions. Perhaps an obvious first question is to ask whether MNCs are indeed more likely to engage in management innovation than other types of firms. This question could be tackled by a more extensive version of the method we used above or another type of quantitative test. But a more sophisticated question to ask may be whether there are certain conditions under which MNCs are more likely to engage in management innovation. For instance, is the extent of presence of foreign MNCs in an industry a positive predictor of management innovation in that industry? Are certain types of entry modes, particularly wholly owned subsidiaries, positively associated with management innovation levels? And does the organizational form of an MNC have a bearing on this outcome? These types of questions would allow for a direct connection between existing knowledge and IB and the emerging field of management innovation.

A second set of questions revolves around the management innovation transfer process used inside MNCs. We know from the diffusion literature that the cross-border transfer of innovations inside MNCs is an important mechanism in the spread of these innovations. Case studies on how such transfer actually takes place, bearing in mind what we know about knowledge transfer already, could shed some light on this question. In fact, there may be existing studies on the knowledge transfer process where the object is a management innovation (but perhaps did not get identified as such). Presumably the transfer process is not always easy or straightforward, so such a study could also help us understand what factors help or hinder transfer.

Third, we would be interested in understanding how implementation of management innovations, both those created inside the firm and those adopted elsewhere, influences an MNC’s performance measures and likelihood of survival in foreign environments. Is it really true that management innovation is both a key source of competitive advantage and a method to overcome the liability of foreignness? And how does management
innovation fare in relation to other types of innovation? In our earlier study (Mol & Birkinshaw, 2009), we found that management innovation had a positive impact on performance in the form of future labor productivity, but could not identify such an effect for either product or process innovation. Obviously, this was only one performance measure in just one sample of firms. Furthermore, we did not compare MNCs and local firms. However, it is easy to see how this question can be linked with IB theory in a very direct manner and how further data and tests may be able to suggest answers to it.

Fourth, we would be interested in better understanding the creation and adoption of management innovations by MNCs from the perspective of key decision makers. To what extent are managers of firm headquarters, regional headquarters, local subsidiaries, or product groups inside MNCs engaged in the types of experimentation require to be successful in management innovation? How do they motivate others in the organization to join in that quest? What shape does the experimentation take, and specifically how does it get organized across borders? And are there large differences along the horizontal dimension of our framework, i.e., between managers at home or abroad? These again would be fascinating questions for a case study or quasi-experimental research design involving cocreation between practitioners and academics. A major challenge in answering them would be to develop appropriate methods. As has been observed recently (Van de Ven & Johnson, 2006), management scholars have not exactly been proliferate when it comes to engaging with practitioners to help them improve their organizations.

These are of course just some directions in which future research on management innovation and the MNC could go, and we believe there are plenty of other valid questions, theoretical angles, and research methods to help progress knowledge in this area.

**CONCLUSIONS**

We believe our review and analysis provide at least some preliminary evidence to suggest that the link between multinational firms and management innovation is one which produces benefits for firms and is worth researching for academics. There is some existing literature in this area, although it has not been integrated or even necessarily been seen from the perspective of management innovation.

In this paper, a distinction was made between innovations which are created internally versus those innovations which are adopted from
elsewhere. We also observed some management innovations that are only meaningful in the context of multinational firms, because they require operations in multiple countries to work, but concluded that the overwhelming majority of implementations of management innovations by MNCs are of innovations which are either local or get transferred from the home base. A framework was then presented to make sense of the different types of innovations, along these two dimensions.

We found that multinational firms engage in a range of management innovations, including in areas like management techniques, organization structures, and marketing concepts. We saw that multinational firms are more likely to engage in management innovation, and provided some basic explanation for why that might be the case. We then sketched a number of directions for future research on management innovation in IB. In concluding, we would like to express our strong belief that the IB literature will be enriched by employing a more explicit focus on management innovation. But there is also much to be learned by scholars of management innovation who are willing to focus on MNCs because, as has been observed so often before in IB, MNCs form the most complex real-life laboratory available to us.

NOTE

1. There is a fourth item, “implementation of new or significantly changed corporate strategies, e.g., mission statement, market share.” We do not think this fourth item meets the definition of management innovation used in this chapter and hence exclude it from the analysis. Including it would not materially change the findings reported below though.

ACKNOWLEDGMENTS

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INNOVATION AND THE MULTINATIONAL ENTERPRISE

Luis Vives, Kazuhiro Asakawa and Silviya Svejenova

ABSTRACT

This paper takes stock of past research in international management, zeroing in on the location, organization, and capabilities for innovation in a multinational enterprise. It then reviews current realities and identifies emergent trends of multinational enterprise innovation to outline avenues for future research. It puts forward the need for further exploration of issues, such as emerging markets as an innovation context and emerging multinationals’ knowledge creation approaches, as well as the particularities of structuring for open innovation and capabilities for global knowledge sharing.

INTRODUCTION

In their book The Future of the Multinational Enterprise, Buckley and Casson (1976) suggested that innovation, and not monopoly power, was the key factor for the development and success of the multinational enterprise (MNE). Since their seminal contribution, a growing strand of the international management (IM) literature has acknowledged and examined the central role of innovation for competitiveness (Ghoshal, 1987; Ghoshal &
Bartlett, 1988; Bartlett & Ghoshal, 1989; Kotabe & Murray, 1990; Dunning, 1994; Zander & Solvell, 2000; Buckley, 2006; Phene & Almeida, 2008). Scholars have argued that as knowledge is distributed around the world, MNEs need to tap into it in order to fuel innovation and sustain their competitive advantage (Doz, Santos, & Williamson, 2001). Thus, in their quest for innovation, MNEs have become globally distributed networks with capabilities to capture, create, cross-fertilize, and integrate knowledge on a worldwide basis (Bartlett & Ghoshal, 1989; Kogut & Zander, 1993; Gupta & Govindarajan, 1994; Hedlund, 1994; Zander & Solvell, 2000; Phene & Almeida, 2008).

IM scholars have investigated the phenomenon of R&D internationalization in the past decades (Behrman & Fischer, 1980; DeMeyer & Mizushima, 1989; Hakanson, 1990; Granstrand, Hakanson, & Sjolander, 1993; Cheng & Bolon, 1993; Gassmann & von Zedtwitz, 1998; Nobel & Birkinshaw, 1998; Brockhoff, 1998; Gerybadze & Reger, 1999; Kuemmerle, 1999; von Zedtwitz & Gassmann, 2002; Penner-Hahn & Shaver, 2005; Ambos & Schlegelmilch, 2007). In this paper we take stock of past research, unravel present tendencies, and suggest new directions and approaches for research on innovation and the MNE in the future. In particular, we focus on three main, interconnected lines of inquiry – location, organization, and capabilities – and their relationship to innovation. The paper is organized as follows. The section “What We Think We Know” reviews diverse scholarly contributions and takes stock of the evolution in topics covered. The section “What We Think We Need to Know” offers a discussion of current realities and future trends of MNEs. Finally, the section “How We Might Focus in the Future on Critical Topics” provides guidance on relevant directions for future research on these topics.

WHAT WE THINK WE KNOW

Over the past decades, IM scholars have paid increasing attention to innovation and its importance for the development and success of the MNE. Within this large body of literature, several factors have been discussed as having an impact on MNE innovation. In this paper, we zero in on the three most significant ones: location, organization, and capabilities.

Location has been recognized as a central dimension in the study of multinational corporations. From the eclectic paradigm (Dunning, 1977, 1988, 1993) to the modern internationalization perspective (Rugman, 1996; Rugman & Verbeke, 2001; Rugman & Verbeke, 2004), location has been
acknowledged as a potential source of advantages and, as a consequence, a reason for the existence of MNEs. Location can have a great impact on innovation. In this paper we discuss the role location plays in the positioning and rollout of MNEs’ innovation activities.

How international operations are organized and managed has been another area that has received substantial attention over the years from students of IM (Doz & Prahalad, 1981; Bartlett & Ghoshal, 1989; Ghoshal & Nohria, 1989; Ghoshal & Bartlett, 1990; Gupta & Govindarajan, 1991, 1994). In this paper we discuss the evolution in, and impact on the organization of innovation activities in MNEs.

Finally, scholarship on MNE capabilities has sought to enhance understanding of the adaptation, integration, and reconfiguration of internal and external skills, resources, and competences that MNEs employ in managing the requirements of their environment. As suggested by Peng (2001, p. 811), MNEs “exist because of their capabilities to transfer and exploit knowledge more effectively in the intrafirm context than through external markets.” This paper will discuss the critical role of capabilities in MNEs’ innovation (Tallman, 1992; Teece, Pisano, & Shuen, 1997; Peng, 2001).

The Location of Innovation: From Home-Country Base to Worldwide Geography

Location has been recognized as an important source of advantages for the MNE (Dunning, 1977, 1988, 1993; Rugman, 1996; Rugman & Verbeke, 2001). However, although early studies recognized the benefits associated with access to international markets, they tended to focus on the opening of sales and/or production subsidiaries abroad (Johanson & Vahlne, 1977), and not innovation. At the time companies maintained innovation-related activities (mostly R&D) close to the headquarters (Cheng & Bolon, 1993; Dunning, 1994).

However, the recognition that new knowledge and technology emergence was increasingly global (Doz et al., 2001) and that MNEs that were able to recognize the differences in country environments could “profit through the system-wide management of this variance” (Kogut, 1989, p. 388) propelled a change. During the 1980s and 1990s, MNEs that had innovation activities grounded in their home markets started to analyze the implications, challenges, and expected payoffs of developing a growing set of innovation efforts in other countries.
The internationalization of innovation activities through their location in international subsidiaries allowed MNEs to obtain greater inputs into their innovation processes, while simultaneously improving their local responsiveness in foreign markets (Cheng & Bolon, 1993; Jones & Davis, 2000; Frost, 2001). This double advantage emerges from the fact that subsidiaries are simultaneously embedded in two contexts: they are part of both the MNE structure that shares knowledge across its various units (Bartlett & Ghoshal, 1989) and the host country environment, which embodies social, professional, and technological relationships among firms, and allows for interfirm knowledge flows (Porter, 1990; Westney, 1993). Resource interdependencies within these two contexts influence the innovation ability of MNE subsidiaries. Hence, the most innovative subsidiaries have greater knowledge exchanges with the host country and are located in more diverse host environments. They tend to assimilate knowledge from those geographic locations that create more knowledge, which contributes to increased scale and quality of innovation (Almeida & Phene, 2004). Therefore, subsidiaries’ innovation activities are driven by the interplay among the subsidiary’s innovation strategy, its evolving technological capabilities, and its embeddedness in the host country’s knowledge sharing community (Frost, 2001). MNEs strategically choose to locate their innovation activities in geographic regions depending on the type of knowledge access and the innovation culture offered (Jones & Davis, 2000; Phene & Almeida, 2008).

Specific geographic regions could be particularly advantageous locations for MNEs’ innovation processes because of various factors: potential spillovers from R&D entities present in the area, available innovation resources, additional externalities that make a location attractive, and benefits of incentives provided by local governments. One particular case of advantageous locations occurs in the presence of “agglomeration economies,” a phenomenon that has been studied by economists (Krugman, 1991) and business researchers (Porter, 1990; Shaver & Flyer, 2000). The so-called “new industrial areas” (Scott, 1988) represent an example of these agglomeration economies, and include cases such as Silicon Valley (Saxenian, 1994), the Southern California electronics industry (Scott, 1993), and the Cambridge science-based industrial cluster in the United Kingdom (Castells & Hall, 1994). MNEs can capitalize on location-specific advantages through an international division of labor among foreign R&D entities, segmenting the innovation process and allocating R&D responsibilities to different subsidiaries depending on their expertise, knowledge, and access to context-specific external resources.

Location can also play a key role in the transfer of innovation. For example, the challenges involved in the transfer of innovations from
more-developed to less-developed markets have been studied extensively. A number of consequences of such transfers have been identified, including a less efficient use of the innovations in the receiving country (Farmer, 1966), or the impossibility of employing an innovation (Solo, 1966). As a solution to these problems, some authors have suggested downgrading a technology or innovation before transferring it to such contexts (Baranson, 1966; Solo, 1966) or, alternatively, restructuring “the context of operations to provide a more hospitable environment for the advanced technology” (Solo, 1966, p. 92).

Therefore, MNEs seeking to innovate in, or transfer innovation and technical knowledge to other geographic regions need to take into account two related aspects that influence the location decision: (1) the presence of a positive innovation culture and context, which is a source of positive spillover effects; (2) the degree of technological and social development of the receiving country, which may enhance or hamper the success of applying the innovation. As the geography of MNE innovation processes evolves, the organization of these activities becomes essential.

Organizing for Innovation: From Centralized, Headquarters-Driven R&D Activities to Distributed Networks

Organizing allows an MNE to successfully channel its innovation processes by accessing and connecting knowledge both residing in its subsidiaries and beyond them in locations where it does not have operations (Doz et al., 2001). IM scholars distinguish between two main approaches to organizing an MNE’s innovation: a “central to global” approach, in which the responsibility for innovation resides in the HQs from where it diffuses to the rest of the organization, and a “local to local” or “local to global” approach, in which local subsidiaries take on responsibility for innovation, which is either for their own consumption or to be further diffused across the MNE (Buckley & Casson, 1976; Rugman, 1981; Granstrand, 1999; Cantwell & Mudambi, 2005).

The latter approach implies a shift from a centralized organization of innovation to a decentralized, distributed innovation network (Bartlett & Ghoshal, 1989). In it, subsidiaries are no longer only market access providers and recipients of a parent company’s technology transfers. They collaborate actively in value creation by searching for, discovering, and recognizing untapped pockets of knowledge, and mobilizing and connecting knowledge for the creation and realization of innovations. The new role of subsidiaries implies that MNEs need to tame their hierarchical nature and the centralized
control of their subsidiaries to become a network that contributes to the innovation process (Mudambi & Navarra, 2004). This process of decentralization implies balancing the local autonomy of the subsidiaries with the MNE headquarters’ control, which can be challenging and cause organizational tensions (Asakawa, 2001). Further, it also requires significant efforts in continuously reconfiguring MNEs’ operations to account for the specifics of each innovation (Verbeke & Yuan, 2007). Thus, although the management of innovation processes in the subsidiaries is decentralized, it is still under the control of the MNE, as decentralization demands coordination.

In their study on the subsidiaries’ effect on MNE performance, Birkinshaw, Hood, and Jonsson (1998) argued that the subsidiaries not only contributed to the firm-specific advantage creation, but also drove the innovation process across the MNE through their own initiative. The role of subsidiary’s initiative is tied to a conceptual model of the MNE as an interorganizational network whereby a subsidiary can enhance the distribution of activities within an MNE through its own initiative. However, for initiatives to be accepted by an MNE’s headquarters, they must be aligned with its strategic priorities. Otherwise, they are likely to be viewed as opportunistic behavior.

The ability of the MNE and its corporate system to effectively leverage that activity in the global market is what makes the subsidiary’s specialized resources part of the firm-specific advantage, thereby suggesting a shift in thinking regarding the role of the subsidiary in the innovation process. Sources of firm-specific advantage and innovation processes of MNEs are increasingly gained outside the home country. Subsidiaries’ initiatives are critical in the process of MNEs’ innovation because they contribute to effective deployment of resources within the MNE’s distributed network. MNEs constitute a differentiated network of dispersed operations, with a configuration of competencies and capabilities that cannot be controlled fully through hierarchical decisions by MNEs’ headquarters. Subsidiaries may be associated with firm-specific advantage development and diffusion processes in their value-creating activities, implying that attempts to classify subsidiaries according to their specific role in the MNE have become less relevant (Rugman & Verbeke, 2001).

Another observable form of decentralization in the organization of subsidiaries is the emergence of centers of excellence (Moore & Birkinshaw, 1998) – organizational units within subsidiaries that embody a set of capabilities explicitly reorganized by the firm as an important source of value creation, with the intention that these capabilities be leveraged by, or disseminated to other parts of the MNE. Centers of excellence enable an
MNE to identify, develop, and leverage capabilities within its network of subsidiaries. Such centers within the subsidiaries are the outcome of a combination of external and internal factors, whereby the MNE headquarters’ investment and linkages to sources of competence, both within and outside the boundaries of the firm, seem to be the most critical factors. But the relative importance of these factors varies across different types of centers of excellence. Subsidiary capabilities are heterogeneous, with each subsidiary developing distinct expertise, often reflecting regional advantages. However, capability development is evolutionary in nature. Studies argue that centers of excellence contribute better to the process of MNEs’ innovation than noncenters (Frost, Birkinshaw, & Ensign, 2002).

Although there is a growing body of literature on subsidiary autonomy (Ghoshal & Nohria, 1989; Gupta & Govindarajan, 1991; Ambos & Schlegelmilch, 2007; Noorderhaven & Harzing, 2009), studies on the impact of such autonomy on innovation show mixed results (Ghoshal, Korine, & Szulanski, 1994; Ghoshal & Bartlett, 1998; Birkinshaw et al., 1998; Schulz, 2001). On the one hand, local autonomy facilitates locally specific innovation due to the lack of constraint imposed by the headquarters. Local subsidiaries are likely to source local knowledge by taking advantage of their freedom (Cantwell, 1995; Asakawa, 2001; Andersson, Forsgren, & Holm, 2002; Ambos & Schlegelmilch, 2007; Soo, Devinney, & Midgley, 2007). On the other hand, local autonomy makes local subsidiaries less willing to integrate themselves back into the intra-MNE networks, for fear of losing their independence (Asakawa, 2001). Nevertheless, local autonomy is also reported to facilitate knowledge transfer within MNEs, especially among overseas subsidiaries (Foss & Pedersen, 2002). More fine-grained empirical studies are called for to identify conditions under which local autonomy contributes to innovation.

For organization and location to materialize in innovation, it is essential for an MNE to develop and leverage company-wide as well as subsidiary-specific capabilities for the creation, transfer, assimilation, and exploitation of new knowledge.

Originally, attention was paid to the MNEs’ ability to create and transfer new technologies and products. Innovation-creation capabilities are about value creation through “searching out and mobilizing untapped pockets of
technology and market intelligence that are scattered across the globe” (Doz et al., 2001, p. 1). Such searching could take place within, as well as outside the local context of a subsidiary. Innovation-transfer capabilities are about the passing of an innovation from the context in which it has been conceived to other subsidiaries that can benefit from it. Transfer implies the ability of translation, especially when an innovation travels between contexts with a range of cultural, political, technological, and economic differences.

Recently, researchers’ focus has changed to the central role played by knowledge in the process of innovation, both as an input and an output, and, in particular, to firms’ absorptive capacity – their “ability to identify, assimilate, and exploit knowledge from the environment” (Cohen & Levinthal, 1989, p. 569). This ability is largely a function of an MNE’s prior knowledge. As a consequence, lack of investment in an area of expertise of the MNE early on may foreclose a future development of a technical capability in that area. The ease of learning, and thus innovation adoption, is affected by the degree to which an innovation is related to the preexisting knowledge base of prospective users (Cohen & Levinthal, 1990). In the context of subsidiaries, Phene and Almeida (2008) separate the notion of absorptive capacity into distinct but related roles of sourcing capability (arising from R&D expertise that enables subsidiaries to effectively recognize and absorb external knowledge) and combinative capability (a managerial capability that permits the integration and recombination of knowledge, although there might be differences across subsidiaries in how this knowledge is utilized).

Two sets of factors influence the subsidiaries’ absorptive capacity, namely the range of external and internal knowledge sources available, and the subsidiary capabilities associated with knowledge absorption and utilization. Phene and Almeida (2008) argue that knowledge absorbed from the host country is useful to subsidiary innovation. Knowledge assimilation from select sources, and subsidiary sourcing and combinative capabilities are critical to the scale and quality of innovation on the subsidiary level. Host country knowledge is critical to the scale and quality of innovation, while the knowledge absorbed from other subsidiaries and the headquarters within the MNE does not lead to increased innovation. The findings on the importance of knowledge assimilated from host country firms for innovation supports earlier research on learning-oriented FDI (Dunning, 1994; Shan & Song, 1997).

Knowledge sourcing varies by country, which leads back to the role of location in the process of MNEs’ innovation (Song & Shin, 2008). Successful knowledge sourcing from a host country depends on that country’s level
of technological capability (Song & Shin, 2008) and economic conditions (Gupta & Govindarajan, 2000). Furthermore, after controlling for the firm’s R&D intensity as a measure for absorptive capacity, sourcing and combinative capabilities still have an important effect on innovation ability. Subsidiaries vary significantly in terms of their innovation capability due to their different mandates. As indicated in past research, some subsidiaries act as low-cost production platforms, while others are managed as centers of excellence (Almeida & Phene, 2004; Phene & Almeida, 2008). A subsidiary’s capability to source local knowledge is influenced by its level of autonomy (Birkinshaw et al., 1998), its experiences in local settings (Luo & Peng, 1999), and its external embeddedness in the local research community (Song, Asakawa, & Chu, 2006).

WHAT WE THINK WE NEED TO KNOW

Redrawing the MNE’s Innovation Landscape

In recent years, MNEs have realized the opportunities emerging countries have to offer beyond their recognized manufacturing and market potential (Vives & Svejenova, 2007). Several multinational companies have decided to expand the reach of their innovation centers, traditionally established in the countries of the triad (Narula & Zanfei, 2004), and have invested heavily in emerging countries, such as China or India, to create new products and processes (Ambos & Ambos, 2009). Significantly different from the past is also the fact that innovations coming from emerging markets are no longer only targeted at other emerging markets, but have the potential to become world-class products that can succeed in developed countries (Immelt, Govindarajan, & Trimble, 2009). These movements have taken place in parallel with the growing importance of emerging multinationals that have been able not only to develop a significant presence and success in developed markets, but also to acquire companies from these markets (Ramamurti & Singh, 2009).

Emerging Markets as the New Context of Innovation

R&D investments and innovation centers have experienced exponential growth in emerging markets over the past two decades. Since the early establishments of R&D centers in India by Texas Instruments in the 1980s, and in China by Motorola in the early 1990s, hundreds of MNEs have established R&D centers in emerging countries (Bruche, 2009). In a way, the
globalization of innovation has followed the earlier interest in emerging countries as a result of their low manufacturing costs and market potential, allowing MNEs to better manage the existing trade-off between global scale and local adaptation.

A growing body of literature has examined various aspects of R&D internationalization in emerging countries, especially in China and India. For China, the growth of international R&D alliances (Li & Zhong, 2003), R&D missions and integration with headquarters of Western MNEs (von Zedtwitz, 2004), rapid upgrades of regional innovation networks in China by MNEs (Cheng, 2007), and the challenges of IP protection (Zhao, 2006; Yang & Jiang, 2007; Quan & Chesbrough, 2010) have been investigated. As for India, market reforms and liberalization favorable for MNEs to localize R&D in India (Bowonder & Richardson, 2000), and knowledge spillovers from MNEs to local firms (Feinberg & Majumdar, 2001; Kathuria, 2001; Manral, 2001) have been studied, among other issues.

One highlight of this process has been the realization of the substantial opportunities provided by developing countries in conceiving relevant innovations. Far from the traditional conception of innovation as the domain of companies from developed economies and the need for downgrading an innovation in its transfer to developing markets (Baranson, 1966), emerging economies can themselves be a context for and a source of value – creating new practices, products, and services for MNEs. The process through which innovations from emerging markets are translated and applied to developed markets has been labelled “reverse innovation” (Immelt et al., 2009).

Reverse innovation defies conventional conceptions of global innovation processes and marks a shift away from the perspective that innovation from emerging countries is less relevant, or only suitable for application to other emerging countries (Immelt et al., 2009). For a successful transformation from the traditional international transfer of innovations to reverse innovation, it is critical to understand and manage the existing differences in the innovation processes between developed and emerging markets (Immelt et al., 2009). Successful processes and practices from developed countries do not necessarily apply in emerging markets; rather, emerging markets offer new opportunities and challenges for managing innovation processes through reverse innovation (Asakawa & Som, 2008).

**Emerging Multinationals’ Approach to Innovation**

In the past two decades, a growing number of companies from emerging markets have become multinational corporations (Aulakh, 2007;
Cuervo-Cazurra, 2008; Ramamurti & Singh, 2009). These “emerging multinationals,” which have traditionally played a secondary role in the global innovation landscape, have begun to develop their own innovative capabilities, leveraging them both in emerging and developed markets (Accenture, 2008; Li & Kozhikode, 2008, 2009).

Mathews (2006) discusses the way in which latecomer and newcomer MNEs, typically from the Asia Pacific region and labeled as “Dragon Multinationals,” established themselves as successful international players. He argues that “the innovative features that these MNEs share, such as their accelerated internationalization, strategic innovation and organizational innovation, fit particularly well with the characteristics of the emergent global economy as one of the complex inter-firm linkages” (Mathews, 2006, p. 5). He then argues that successful internationalization of these late or newcomer MNEs is at odds with the dominant OLI (ownership, location, internationalization) perspective on the multinational advantage.

Wu, Ma, and Shi (2010) show how latecomer firms capture value from disruptive technology. They find that latecomer firms utilize strategic partners’ complementary assets to build unique value networks embedded in local infrastructure, thereby bypassing the global advantages of multinational incumbents. Siqueira and Bruton (2010) highlight high-technology entrepreneurship in emerging economies and show how this differs from that of developed economies. They find that firm informality in an emerging economy positively moderates the relationship between resources and firm performance. They argue that the difference in high-tech entrepreneurship between the developed and developing economies lies in the extent of resource constraints and higher level of firm informality in emerging economies. Li, Zhang, Liu, and Li (2010) investigate organizational mechanisms through which acquisitive learning contributes to indigenous innovation of Chinese firms. This line of research suggests that the way emerging MNEs innovate differs to a large extent from the way Western MNEs innovate.

The increasing importance of emerging countries has various implications for MNEs. Developing countries are a source of relevant innovations not only for other developing markets, but also for the markets of developed countries. MNEs need to encourage innovation activities in emerging markets and develop mechanisms to transfer these innovations and technologies to serve customers in developed countries. By approaching new customer segments and radically transforming existing processes, reverse innovation can help developed countries to leverage those new practices. Asia’s recent transformation from a low-cost manufacturing region with low-income consumers to a hub for emerging centers that generate new
products and technologies is the most salient case. Asian nations are no longer simply an epicenter of IP infringement or technological upgrading in global supply chains, but are also important global players who create and use new products and services (Dodgson, 2009).

A complementary direction for future research is how emerging MNEs innovate. Most of the literature has focused on innovation processes and practices in developed country MNEs. Little has been written about how emerging MNEs approach innovation. For example, Li and Kozhikode (2008) highlight how resource-poor latecomer firms in emerging economies catch up with MNE incumbents by focusing on learning. Based on the strategic intent of latecomers, they distinguish between emulators and blind imitators, the former able to develop flexible routines to successfully compete with incumbents.

Those MNEs without initial ownership advantages resort to external networks through which key resources can be obtained and leveraged. Extant IM theories that relied on the dominant OLI paradigm have not anticipated the surge of emerging multinationals from the periphery part of the globe. Thus, close examination of emerging multinationals provides a huge opportunity to rethink extant and advancing new IM frameworks.

Reorganizing the MNE for Innovation

*Autonomy, Embeddedness, and the Dynamics of Innovation*

Four main issues demand further attention in regards to organizing. First, the optimal level of autonomy deserves further investigation. As discussed above, studies of the impact of subsidiary autonomy on innovation have shown mixed results (Ghoshal et al., 1994; Ghoshal & Bartlett, 1998; Birkinshaw et al., 1998; Schulz, 2001; Cantwell, 1995; Asakawa, 2001; Andersson et al., 2002; Ambos & Schlegelmilch, 2007). Further empirical studies are necessary to identify conditions under which local autonomy contributes to innovation. According to Birkinshaw, Bouquet, and Ambos (2006a), subsidiaries can get attention from headquarters and local autonomy at the same time. If so, it would be relevant to investigate which type of subsidiary autonomy – with or without the headquarters’ attention – contributes more to subsidiary innovation. Furthermore, the extant literature on subsidiary autonomy and innovation largely deals with the phenomenon in a static manner. More dynamic treatment of subsidiary autonomy and its impact on innovation is called for.

Second, optimal levels of external and internal embeddedness need to be investigated further. According to Andersson, Forsgren, and Holm (2007),
external embeddedness contributes to the competence of the subsidiary, while it also lowers the subsidiary’s interest in contributing to performance of MNEs. Interunit linkages and knowledge sharing are considered to be beneficial for innovation performance (Ghoshal et al., 1994; Kotabe, Dunlap-Hinkler, Parente, & Mishra, 2007). However, an excessive degree of interunit linkages, especially between the headquarters and subsidiaries, would stifle subsidiaries’ innovation and creativity. In the literature on international R&D, balancing the external and internal embeddedness has been examined (Hakanson, 1990; Gassmann & von Zedtwitz, 1999; Asakawa, 2001). Still much more refined and dynamic observation of the optimal balance between the external and internal embeddedness is expected in this field.

Third, the effects of subsidiary isolation on innovation deserve further investigation. Compared to the effect of subsidiary autonomy on innovation, very little attention has been paid to the effect of subsidiary isolation on innovation. While subsidiary autonomy and subsidiary isolation look similar, they are different concepts. Antecedents of subsidiary autonomy have been investigated (Asakawa, 2001; Monteiro, Arvidsson, & Birkinshaw, 2008; Williams & Nones, 2009). Monteiro et al. (2008) show that isolated minor subsidiaries underperform other better-connected subsidiaries, implying the liability of isolation. However, the impact of subsidiary isolation on innovation has not been examined. Further empirical studies that focus on the impact of subsidiary isolation on subsidiary’s innovation are required.

Fourth, relocation of headquarters and its impact on innovation needs to be discussed further. The recent phenomenon of relocating the corporate or divisional headquarters abroad is attracting attention in the field of IM (Birkinshaw, Braunerhjelm, Holm, & Terjesen, 2006b; Barner-Rasmussen, Piekkari, & Bjoerkman, 2007). What are the consequences of such a move for the innovation activities of MNEs? Relocating the corporate or divisional headquarters means relocating core functions that are typically conducted at the headquarters in an MNE’s home country (Barner-Rasmussen et al., 2007). Since innovation is expected to be tightly linked to the corporate strategy, relocation of headquarters should affect an MNE’s overall policy toward global innovation. Compared to the impact of R&D internationalization on innovation, little attention has been paid to the impact of headquarters relocation on innovation.

Organizing for Open Innovation

Recent studies suggest that most innovations involve several organizations and, in that regard, contemporary MNEs become flexible organizing entities that coordinate a network of intra- and interfirm relationships
However, extant research has focused mostly on innovations developed within the boundaries of the MNE, with the exception of studies examining MNEs’ innovation through the use of joint ventures, alliances, or other collaborative arrangements (e.g., Inkpen & Dinur, 1998; Tsang, 2002). In addition to collaborating, MNEs can acquire novel technologies and products, both of which imply open innovation.

Open innovation depicts an emergent model of innovation in which MNEs source novelty outside their boundaries through their global network (Chesbrough, 2003), and partake in collaborative innovation by innovation communities (von Hippel, 2001). In some cases, this innovation activity can take place in a nonproprietary manner. The open innovation paradigm is the counter argument to the internalization perspective, the traditional vertical integration model, where internal innovation activities lead to internally developed products and services that are then distributed by the MNE. In other words, open innovation is “the use of purposive inflows and outflows of knowledge to accelerate internal innovation and expand markets for external use of innovation, respectively” (Chesbrough, 2006, p. 1).

One requirement that becomes salient with the implementation of innovation systems that are external to the firm is the governance of innovation that takes into account both internal and external processes (Li & Kozhikode, 2009). Since normally the development of external innovation practices does not imply the discontinuation of internal innovation activities, the MNE will require the development of ambidextrous practices that allow the management of both external and internal innovation.

Open innovation on a global scale involves tapping into innovation clusters scattered all over the world. Developing and leveraging global networks structures for diffusing knowledge constitute the MNE’s global innovation system (Spencer, 2003). In theory, MNEs would tap into innovation clusters both within and outside their home countries. However, due to strong bias toward home-country advantage for MNEs (Hymer, 1960; Vernon, 1966; Dunning, 1981; Porter, 1990), the tendency remains prevalent for MNEs to tap into home-country innovation clusters, especially for those based in home countries with strong technological capabilities. MNEs based in home countries with a weak competency base would naturally seek to tap into competency clusters located abroad (Doz et al., 2001). In contrast, further research is required to identify conditions under which MNEs that originated in home countries with strong innovation clusters would relocate their innovation activities abroad.
Further attention should also be paid to the problems that emerge because of the “openness” of open innovation; e.g., IP security (Burkett & Finley, 2007), in which norms-based IP systems could complement or serve as a substitute for law-based IP systems (Fauchart & von Hippel, 2008).

**Reshaping the MNE’s Innovation Capability**

*Capabilities Facilitating Knowledge Sourcing*

The capability to source knowledge from overseas locations has been discussed in the extant literature (Cantwell, 1995; Birkinshaw et al., 1998; Andersson et al., 2002; Song & Shin, 2008). According to the capability-based view, it is a prerequisite for a subsidiary to have sufficient absorptive capacity (Cohen & Levinthal, 1990) in order to sense, acquire, and leverage external knowledge residing in the host country. However, Song and Shin (2008) point out a paradox of capabilities and motivation in sourcing external knowledge from host countries. We still need to know a great deal more about how the absorptive capacity of a MNE will not make it complacent and less motivated to source knowledge from the host country environment. Furthermore, Song et al. (2006) found that there is an inverted U-shaped relation between the absorptive capacity of an overseas subsidiary and the sourcing of external knowledge from the home country. Future studies need to advance our knowledge about the optimal level of absorptive capacity for an overseas subsidiary to maintain, so as to source knowledge from the host country environment most successfully.

The capability to transfer local knowledge within the MNE network is different in nature from that of sourcing external knowledge. The extent to which a subsidiary contributes to MNE innovation depends on the capability of the subsidiary and the MNE to transfer knowledge (Cantwell, 1995; Ambos, Ambos, & Schlegelmilch, 2006; Ambos & Ambos, 2007). Factors affecting transfer of knowledge from a subsidiary to the headquarters have been investigated (Gupta & Govindarajan, 2000; Schulz, 2001; Asakawa & Lehrer, 2003). This reflects a growing body of literature on reverse knowledge flow (Hakanson & Nobel, 2001; Frost & Zhou, 2005; Yang, Mudambi, & Meyer, 2008; Lorraine, 2009). Nevertheless, the capability required for facilitating such reverse knowledge flow has not been sufficiently examined. In the meantime, an increasing number of researchers are shedding light on the underlying mechanisms that facilitate reverse knowledge transfer from subsidiary to headquarters.
**Capabilities for Knowledge Sharing**

Frost and Zhou (2005, p. 678) found that R&D “co-practice,” defined as “collaborative technical activities carried out jointly by R&D personnel from two or more organizational subunits,” contributes to the development of absorptive capacity and social capital, which are necessary for facilitating knowledge sharing. Such a finding is consistent with Ghoshal et al. (1994), who found that frequent communication among managers contributes to interunit knowledge links, and with Almeida and Kogut (1999), who showed that knowledge flows are enhanced by the mobility of engineers. Similarly, Boyacigiller (1990), and Bjorkman, Barner-Rasmussen, and Li (2004) argued that an organizational capability to motivate the employees to transfer knowledge by way of appropriate human resource practices is also effective. Repatriating employees to the headquarters is another opportunity for reverse knowledge flow (Lazarova & Tarique, 2005). These mechanisms and capabilities are indispensable for transferring knowledge across borders, especially when the knowledge is tacit and sticky (Jensen & Szulanski, 2004). Future study should continue to advance, in a much more detailed way, the mechanisms by which certain capabilities enhances reverse knowledge flows from subsidiaries to headquarters and/or other peer subsidiaries.

**HOW WE MIGHT FOCUS IN THE FUTURE ON CRITICAL TOPICS**

*How do MNEs Operating in, or Originating from, Emerging Markets Innovate?*

As for the topic of innovation in emerging countries by MNEs, we see the following directions for future research. First, extant research tends to focus on India and China as locations for conducting innovation. Although these countries remain important for MNEs to conduct innovation, future studies should expand their focus to other emerging countries as well. Furthermore, our attention should go beyond the BRIC (Brazil, Russia, India, and China) countries. For example, the Middle East and Africa have been largely ignored as host locations for R&D and innovation (indeed, for most studies in the IM field). However, recent phenomena show that MNEs started to conduct R&D in photovoltaic power generation in the Middle East and R&D in mobile phone banking systems in Africa (Mahajan, 2009).
Second, the choice of location for innovation activities in emerging countries can be studied in the context of brain circulation (Saxenian, 2006). For example, mobility of highly educated engineers and entrepreneurs among the Silicon Valley, Hsinchu, and Shanghai would rapidly upgrade the technological competencies of Asian countries. It is largely misleading to assess future potential of China and Taiwan as independent host countries without taking such brain circulation into account. Future research needs to shed light on evolving patterns of brain circulation on a global scale so as to accurately assess the potential of innovation in each emerging country.

Third, future study of innovation in emerging markets needs to take into account multilayered aspects of emerging markets. MNEs’ approaches to the middle-class market segment should differ from approaches to the lower segment, or what they call the “bottom (or base) of the pyramid” (Prahalad & Hart, 2002; Prahalad & Hammond, 2002; Hart & Simanis, 2005; Anderson & Markides, 2007; Karnani, 2007; Akula, 2008; Warnholz, 2008; London, 2009). Contrary to conventional wisdom that assumes that the bottom of the pyramid is merely a target for charity and assistance, MNEs can identify potential for innovation by paying much closer attention to the needs of the people in this segment (Mahajan, 2009).

As for MNEs from emerging countries, we see some critical questions that deserve further attention. First, we need to understand how emerging-country MNEs innovate. More specifically, how different are emerging-country MNEs from those from developed countries in terms of conducting innovation on a global scale? We need to show the extent to which the existing literature on global innovation can be applied to the case of emerging-country MNEs.

Second, we still do not know a great deal about the home-country factors of MNEs from emerging countries for conducting innovation on a global scale. For example, how different are Indian firms from Chinese firms in terms of their approaches to global innovation? We need to pay attention to differences among home countries within emerging markets in a much more refined way.

What are the Challenges for MNEs in Implementing Open Innovation?

The implementation of boundaryless innovation practices has several implications and poses several challenges for the MNE. On the one hand, MNEs need to learn how to loosen control over the total process of creation of innovation. Although part of the innovation may still be developed within its boundaries, the MNE needs to establish mechanisms for
identifying, integrating, and leveraging innovations created outside its boundaries.

Also, while MNEs can easily claim rights and appropriate rents from the innovations developed within their boundaries, they might experience weak intellectual property rights and unintended knowledge spillovers from boundaryless or open innovation practices. These practices may require the creation of new and nonconventional ways of sharing the value being created, so as not to create a tendency to underinvest in innovation from society’s point of view, due to firms’ problems in appropriating the economic benefits (Arrow, 1962).

MNEs that are engaged in open innovation, such as IBM and P&G, tend to have a strong corporate dominant logic among top management favoring open innovation (Chesbrough, 2003). In reality, not all MNEs have top management with strong leadership that is supportive of open innovation, so how can MNEs without strong top management support for open innovation implement it successfully on a global scale? Future study may shed light on the relations between the corporate dominant logic among top management and the implementation of open innovation.

We also need to better understand the mechanisms by which boundaryless innovation is implemented by MNEs. The mechanisms include incentive systems that apply to the employees and to the outsiders who are involved in innovation for the MNEs. How should MNEs reward the insiders and outsiders in a fair manner? Further investigation into appropriate incentive systems and other mechanisms for boundaryless innovation is required.

How Does a Global Innovation Capability Emerge and Evolve?

Exposed to multifaceted challenges, such as coping with emerging economies and open innovation, MNEs need to redefine their capabilities for conducting innovation on a global scale. As for the surge of emerging markets for MNEs as well as the surge of the emerging-country MNEs, we need to analyze the extent to which capabilities that are valid in the Western context can be applied to the emerging-country setting.

As for the capability of implementing open innovation, different kinds of capabilities are required along the line of innovation cycle (Doz et al., 2001). In the phase of global knowledge searching, required capabilities include searching and accessing the appropriate knowledge abroad. In the phase of leveraging the acquired knowledge, required capabilities include combining and integrating the newly acquired knowledge into the existing knowledge
base within the MNEs, and making use of it for new product development and commercialization. The remaining issue here is the way different capabilities are relayed as the innovation cycle evolves over time. The sensing capability becomes less meaningful once a certain innovation project enters a new stage of leveraging the acquired knowledge internally. How can managers effectively switch among different capability modes along the evolving innovation cycle?

**CONCLUSION: BRINGING TOGETHER PAST, PRESENT, AND FUTURE RESEARCH ON INNOVATION AND THE MNE**

In this paper, we showed that innovation is a major topic in IM research and we focused on reviewing extant work on three main factors that influence innovation: location, organization, and capabilities. We revealed that scholarly interest in the location of innovation has evolved to capture not only the role of the home country in the sourcing of new knowledge, but also the increasingly globalizing geography of the MNEs’ innovation activities. We also discussed how extant studies have captured the organizing of innovation from a centralized, headquarters-driven model to one that is based on an internationally distributed innovation network. We also accounted for the changed interest in MNEs’ innovation capabilities, from a focus on knowledge creation and transfer from developed to developing countries, to a much richer depiction of international knowledge sourcing and the importance of the absorptive capacity of the different subsidiaries of the MNE.

In an attempt to take stock of current realities and emergent trends in relation to MNEs’ innovation, we explored three related areas. First, we suggested the importance of redrawing the MNEs’ innovation landscape, proposing further exploration of emerging markets as the new context for innovation and of emerging multinationals’ approach to new knowledge creation. Second, we argued that scholars should continue delving into the issue of organizing, examining issues, such as autonomy, embeddedness, and dynamics, as well as the particularities of structuring for open innovation. Last, we posited that attention should be paid to the reshaping of MNEs’ innovation capabilities, with particular emphasis on those that facilitate global knowledge source and sharing.

Finally, we proposed that emerging markets, open innovation, and capability dynamics constitute three important avenues for further research,
among a wealth of other topics worth pursuing. After all, the scholarly domain of MNEs’ innovation is ripe for new contributions that would not only update the theories and create new ones, but also inform practice on phenomena that are timely and relevant for competitiveness.

NOTES

1. Although we acknowledge the differences between innovation and R&D, we use them interchangeably throughout the paper, given the historical shift in focus in the literature from R&D to innovation.
2. Early studies mainly investigated MNEs from developed markets – the United States, Japan, and Western Europe.
3. Some MNEs in advanced stages of internationalization have engaged in international innovation processes since the 1960s and 1970s, which were analyzed by authors, such as Granstrand (1982).

REFERENCES


E. INTERNATIONALIZATION
A MULTILEVEL APPROACH TO UNDERSTANDING THE MULTINATIONALITY–PERFORMANCE RELATIONSHIP

Bo Bernhard Nielsen and Sabina Nielsen

ABSTRACT

This paper offers a discussion of the key multilevel issues pertaining to the multinationality–performance (M–P) relationship. Arguably, one of the most important areas of research in international business, firm internationalization and its consequences are multilevel phenomena, influenced by forces at different managerial and structural levels: from the executive, subsidiary and firm, to the country and industry. We suggest that accounting for important factors at each level and for their cross-level interactions may help reconcile inconsistent findings and advance our understanding of the M–P relationship. Based on a critical review of the literature, we offer recommendations regarding the appropriate levels of theory, measurement, and analysis to guide future research.

INTRODUCTION

The relationship between firm multinationality and performance (hereinafter referred to as the M–P relationship) is a core research issue in
international business that continues to draw enormous scholarly attention. Despite this attention, and the rich and impressive body of conceptual and empirical work, important limitations to our understanding of this relationship exist. Labeled and operationalized differently across studies and approached from a diverse range of theoretical perspectives (for reviews, see Hitt, Tihanyi, Miller, & Connelly, 2006; Li, 2007), exactly how multinationality influences firm performance is subject to much contention backed up by mixed and conflicting results (Bausch & Krist, 2007; Capar & Kotabe, 2003; Hennart, 2007; Verbeke & Brugman, 2009). The empirical findings appear to be highly susceptible to choices concerning theoretical perspectives, measures of M–P, time period, and national context, in addition to moderating and control variables and method of analysis.

In our view, much of this inconsistency can be attributed to the inherently multilevel nature of the phenomenon; the M–P relationship is a function of the nested structure of firm strategy within industry and country contexts. Little effort has been devoted to defining the level at which theory and constructs operate, and theory development has only infrequently addressed explicitly the role played by variables at different levels. Moreover, although most researchers would agree that the M–P relationship is inherently multilevel, existing research primarily studies this relationship at a single (often aggregated) level of analysis without acknowledging other effects at different levels of analysis, as well as potential cross-level effects.

This paper begins with a synopsis of the progress made theoretically and empirically during the past decades. Next, we argue that the multilevel nature of the M–P phenomenon warrants a deeper investigation of this relationship at the level of theory, measurement, and analysis. We argue that identification and specification of the relevant constructs at each level of theory, as well as their cross-level interactions, can shed new light on the M–P relationship and help reconcile existing inconsistencies in the literature. We close the paper by providing specific recommendations to guide future research.

STATE-OF-THE-ART OF RESEARCH ON MULTINATIONALITY–PERFORMANCE

Theories Explaining the Costs/Benefits of International Diversification

International business scholars have endorsed a wide variety of theoretical approaches in an attempt to explain the M–P relationship: ranging from
finance theory via internalization theory to resource-based and organizational learning theories. These theories differ in their intellectual heritage, research focus, and underlying assumptions, and operate at different levels. Despite this pluralism in theoretical approaches, M–P research has mostly been approached at a single level of analysis (i.e., the firm or the multinational corporation) and only limited attempts have been made to bridge levels in order to understand the M–P relationship as embedded in different layers of context. The following section provides a brief overview of the most widely used theories and their prediction as to the anticipated costs and benefits of internationalization.

Internalization Theory
Internalization theory (Buckley & Casson, 1976) is one of the most widely applied theories of firm internationalization. Based on a Coasian logic of transaction costs theory (Coase, 1937), it views the firm as a complex set of interdependent activities linked by flows of knowledge and intermediate products. Firms aim to maximize profit by internalizing the intermediate markets across national boundaries in the face of market imperfections. Benefits of internalization arise from the avoidance of imperfections in the external market, but there are also costs associated with coordinating the internal division of labor. The boundaries of a firm are set where the costs and benefits of further internalization of markets are equalized at the margin (Buckley & Casson, 2009). As such, internalization theory explains under what conditions MNCs can extract above average returns from exploiting firm-specific advantages abroad.

Internalization theory specifies that intangible assets, such as technological know-how, patents, management skills, brands, and goodwill are information intensive and that transactions involving those assets are potentially subject to market failure. For efficient exploitation, the cross-border exchange of these assets must be internalized (Caves, 1971; Lu & Beamish, 2004). The range of locations in which a firm operates is determined by the rational cost–benefit analysis of internalizing intermediate markets; performance is maximized by identifying the optimal level of internalization constrained by the diminishing returns to managerial coordination.

Resource-Based Theory
The resource-based theory of the firm suggests that leveraging idiosyncratic organizational capabilities or tacit knowledge-based routines (strategic resources) across national markets will provide economies of scope, in addition to appropriation rents from more customers, and thus positively
influence performance (Barney, 1991; Conner, 1991; Fladmoe-Lindquist & Tallman, 1994; Geringer, Tallman, & Olsen, 2000). Firms with profit-making internal competencies (firm-specific ownership advantages) will seek additional profits in international market locations, either through exports, or through direct investment (Dunning, 1988). As long as the ownership advantages can be applied profitably, greater international market presence should generate higher performance.

The ability to manage extensive networks of international subsidiaries at relatively low transaction costs may be a key capability and source of competitive advantage for successful MNCs (Fladmoe-Lindquist & Tallman, 1994). Organizational learning and experiences arising from complex domestic environments may help reduce the otherwise increasing bureaucratic costs associated with international expansion. For instance, prior product diversification is likely to provide the firm with experience in managing multiple product markets, which can be exploited in international markets. As a result, resource-based theory predicts a monotonic M–P relationship.

Learning Theory
Learning theory (Johanson & Vahlne, 1977) views internationalization as an incremental process that fosters organizational learning and knowledge development not available to domestically operating firms (Barkema & Vermeulen, 1998; Hamel, 1991). Through gradual acquisition, integration, and use of knowledge about foreign markets and their idiosyncrasies, the internationalization process offers firms the opportunity to gain a competitive advantage over less internationally active competitors. In this context, experiential knowledge, in the form of either general knowledge about international operations or market-specific knowledge, constitutes the critical dimension of the human resources that should be reflected in improved products and services, and thus ultimately contribute to superior firm performance (Johanson & Vahlne, 1977).

Organizational learning theory focuses on the development of routines to manage the complexities and uncertainties associated with internationalization (Collis, 1994). This process is a time-dependent, firm-specific, and path-dependent learning mechanism that includes practice, codification, mistakes, and pacing (Eisenhardt & Martin, 2000) that allows firms to acquire and accumulate knowledge that can be used to build additional value. Firms that compete in international markets can draw from multiple diverse knowledge bases in their research and development, manufacturing, and marketing operations to learn new skills that augment current capabilities.
(Zahra, Ireland, & Hitt, 2000). At the same time, firms face organizational constraints such as limited absorptive capacity (Cohen & Levinthal, 1990) or the difficulty and expense of processing large amounts of (foreign) information (Simon, 1955).

**Finance Theory**

Internationalization increases the exposure to financial and political risks, such as currency fluctuations, government regulations, and trade laws. At the same time, portfolio diversification hedges against adverse changes in host country environments and geographical dispersion of activities helps spread the risks of foreign direct investments across multiple international markets (Shapiro, 1978). Such international markets are subject to different business cycles and varying exposure to environmental shocks (such as a global crisis), which likely positively influences the M–P relationship. A main prediction, originating from finance theory, argues for the possibility of risk-reduction via uncorrelated portfolio investments in diverse countries that are not economically integrated (Shapiro, 1978).

**New Institutional Theory**

The institutional environments within which a firm operates exert important influences on the strategies, structures, and practices of the multinational firm. Different institutional structures interact to form distinct national or regional configurations that may enhance or constrain a firm’s ability to extract value from international business activities. Scott (1995) provides a useful classification of the institutional environment as multifaceted systems incorporating regulative processes, normative rules, and cognitive constructions. The regulative pillar refers to rules and laws that exist to ensure stability and order in societies; the normative pillar refers to the domain of social values, cultures, and norms; and the cognitive pillar refers to the established cognitive structures in society that are taken for granted.

When applied to the context of firm internationalization, the key argument of institutional theory is that the more different the host country is from the home country in terms of formal and informal institutions, the more difficult and costly it is for the MNC to extract value from business activities in this country. This is due to additional costs related to adjusting to different laws, regulations, local norms, and the like, which gives rise to liability of foreignness (LOF) (Hymer, 1976; Zaheer, 1995; as well as Ramachandran & Pant, this volume; Mezias & Mezias, this volume; Bell, Filatotchev, & Rasheed, this volume). All other things equal, local firms
enjoy a comparative advantage from being familiar with the home country institutional environment, particularly the normative (cultural) component.

**Summary of Costs and Benefits of Internationalization**

Summarizing the theoretical arguments presented, being internationally diversified increases profitability because (1) it allows for exploitation of economies of scale and amortization of fixed investments over a larger market (Contractor, Kundu, & Hsu, 2003; Hitt, Hoskisson, & Kim, 1997); (2) it provides better and more flexible access to (country-specific) resources (Contractor et al., 2003) as well as the opportunity to hedge effects of adverse changes in the host country institutional and macroeconomic environments (Kim, Hwang, & Burgers, 1993); and (3) it allows for more learning through multiple stimuli from diverse cultures and markets (Contractor et al., 2003; Hitt et al., 1997; Kim et al., 1993). These three potential benefits of multinationality are essentially consistent with the view of the MNC as: (1) an exploiter of internalized capabilities (internalization theory; Buckley & Casson, 1976; Rugman & Verbeke, 2003), (2) a coordinator and arbitrator across national borders (theory of portfolio diversification; Eiteman & Stonehill, 1979), and/or (3) a learning organization absorbing valuable knowledge from abroad (organizational learning theory and behavioral theory of internationalization; Johanson & Vahlne, 1977). Following these logics, a variety of scholars have proposed and empirically tested a positive M–P relationship (e.g., Delios & Beamish, 1999).

Although multinationality may bring benefits to the MNC, recent research also points at the attendant costs associated with internationalization. Such costs accrue due to the unfamiliarity the foreign firm has with the formal and informal institutions of the host country, as well as other sociopolitical factors that may lead to discrimination against foreign firms. Relative to domestic competitors, foreign firms face additional costs of local adaptation as well as learning about a new culture, which translates into a LOF and newness because such firms cannot conduct business activities as effectively as their domestic counterparts (Hymer, 1976; Stinchcombe, 1965). For every additional international operation or market added, there would continue to be learning, coordination, local adaptation, and legitimacy acquisition costs despite any learning effects from conducting business in a particular host country or internationally, in general (Jones & Hill, 1988). As the number of internal transactions increases with the number of foreign subsidiaries established by a firm, governance costs can
rise rapidly to a point at which the governance costs exceed any internalization benefits (Hitt et al., 1997; Tallman & Li, 1996).

As a firm expands the number of host countries in which it operates, the governance costs and coordination costs associated with increasing multinationality are compounded. Each country has a unique business environment and expanding into dissimilar markets increases environmental uncertainty, which will further raise the costs of hierarchical governance. The coordination of operations across disparate host countries leads to diseconomies in managing larger and larger operations (Bartlett & Ghoshal, 1989, p. 87) that significantly increase information-processing demands on a firm’s managers and administrative systems (Hitt et al., 1997). Hence, although the majority of the literature predicts a generally positive and monotonic M–P relationship, recent investigations have proposed a more complex relationship based on the inclusion of costs of undertaking and coordinating (additional) international value-adding activities.

**Empirical Evidence: Toward S-Curve Logic**

Given the diversity in explanations for the M–P relationship suggested by the theoretical literature, it is hardly surprising that limited empirical consensus has been established in the field. Studies report anything from negative or insignificant relationships, to positive linear, U-shaped, inverted U-shaped, or sigmoid (S-shaped) M–P relationships. A brief review of these studies is presented below in order to trace the evolution of our empirical understanding of the M–P relationship.

**Positive Linear M–P Relationship**

Early work examining the M–P relationship hypothesized and found support for a positive, linear impact of firm international expansion on performance. For example, consistent with theoretical arguments described earlier, Grant (1987) found a positive, linear relationship between M–P for a sample of British firms while Geringer, Beamish, and daCosta (1989) and Hitt et al. (1997) found similar results for U.S. MNCs.

**Negative M–P Relationship**

However, other researchers found evidence that the costs of internationalization may outweigh the benefits. For instance, Denis, Denis, and Yost (2002) studied a large sample of U.S. MNCs and discovered a significant, negative relationship between global diversification, and firm value.
Moreover, they also found that firms that become globally diversified experience downward revisions in their excess value,\(^1\) while firms that cease being internationally diversified experience increases in excess value. According to their interpretation, the additional costs of operating and monitoring global operations render global diversification policies unprofitable on average when compared to the alternative strategies of industrial diversification and/or domestic expansion. Christophe and Pfeiffer (2002) and Click and Harrison (2000) find similar results, while Geringer et al. (2000) also found marginally negative effects of \(M\) on \(P\) in the case of Japan; however, their results were weak and mostly insignificant.

Inverted U-Shaped \(M–P\) Relationship

It is often suggested that higher levels of international diversification, especially combined with product diversification and expansion into markets that are physically and culturally more distant, greatly enhances the transaction costs and information processing demands (Hitt, Hoskisson, & Ireland, 1994). Thus, the more a firm is diversified internationally, the more complex will be its operations. Tallman and Li (1996) suggest that performance will vary with international diversity nonlinearly, increasing as strategic resources are given greater scope but decreasing as product scope exceeds the range of these resources and governance scope surpasses management capabilities. Consequently, performance will suffer beyond a certain point, suggesting an inverse U-shaped curvilinear relationship between multinationality and performance. Several studies show empirical consistency with this thinking: beyond a certain level of international diversification, performance begins to decline (Tallman & Li, 1996; Hitt et al., 1997; Gomes & Ramaswamy, 1999; Kotabe, Srinivasan, & Aulakh, 2002).

U-Shaped \(M–P\) Relationship

Drawing on organizational learning theory, some researchers emphasize that although international diversification is costly, firms learn over time from their experiences and become more effective and efficient at managing international operations (Johanson & Vahlne, 1977). We have noted how international expansion can be fraught with extreme costs that lead to declining performance with initial international diversification. However, such diseconomies of international scale in the short run may be offset by international economies of scale and scope as firms learn to adapt their products and services and lower their costs on a worldwide basis. Such logic would imply a U-shaped relationship between multinationality and performance as the initial negative performance would be offset by

**S-Shaped M–P Relationship**
Combining arguments from internalization, learning, and finance theories, M–P researchers have identified an S-shaped M–P curve, which suggests that firms go through three distinct stages as part of their internationalization process. Consistent with this, Lu and Beamish (2001, 2004) contend that the returns from a geographic diversification strategy are related to costs and benefits that vary depending on the extent of a firm’s multinationality. At the initial stages of international expansion, a firm encounters liabilities of newness and foreignness (Zaheer, 1995) leading to net cost disadvantages and hence decreased performance. However, with increasing internationalization, experiential learning reduces these costs, while, at the same time, the growing dispersion of international activities leads to increased governance and coordination costs. On the benefit side, growing geographic diversification enables asset advantages to be exploited across a greater number of markets and the development of new capabilities in serving international markets. As a result, medium levels of internationalization are associated with growth in a firm’s profitability. Finally, as a firm’s foreign activities become more extensive, governance and coordination costs escalate to the point where costs may again surpass the benefits of internationalization, and firm performance declines. As a result, the central proposition of the S-curve reasoning is that firms should expect a drop in performance as they begin to internationalize, but should then pursue their efforts toward higher multinationality, while avoiding overextension.

Empirically, only a handful of studies have tested the S-curve logic with some evidence of support (Contractor et al., 2003; Li, 2005; Lu & Beamish, 2004; Thomas & Eden, 2004). For instance, Contractor et al. (2003) found support for an S-shaped M–P relationship but only for a subsample of firms in knowledge-based industries. In addition, with the exception of Thomas and Eden (2004), few studies address dynamic aspects, such as short-term and long-term effects of multinationality, on performance.

**Systematic M–P Relationship?**
As pointed out by Hennart (2007), there may be limited reasons to expect any systematic relationship between M–P at the level of aggregation
that most studies use. If such a relationship exists, it may be important to tease out the independent (and combined) effects of variables operating at multiple levels, such as subsidiary, firm, industry, and country level. For instance, industry-level variations in competitiveness and cost structures, in addition to availability of home and host country factor endowments, may throw important light on the costs and benefits of international diversification of particular firms. In our opinion, some – if not most – of the inconsistent findings in the M–P research can be attributed to lack of attention to levels of: (1) theory, (2) measurement, and (3) analysis. In the following section, we explain why specifying and matching levels of theory, measurement, and analysis is critical for management research in general before discussing each of the three multilevel issues specifically in relation to M–P research.

**ATTENTION TO LEVELS OF THEORY, MEASUREMENT, AND ANALYSIS**

*Levels Issues in Management Research*

Management phenomena are inherently complex and often influenced by factors at multiple levels. Hence, variability in the dependent variable may originate from multiple sources that traverse levels of analysis. As a result, scholars need to simultaneously consider the levels of theory, measurement, and analysis for the constructs included in their investigations in order to avoid biases, fallacies, and misinformation (Rousseau, 1985). A mismatch between level of theory, measurement, and analysis may result in violating analytical assumptions or drawing wrong conclusions.

Level of theory refers to the focal unit (e.g., firm or MNC) that a researcher aims to explain, that is “it is the level to which generalizations are made” (Rousseau, 1985, p. 4). The focal unit determines the appropriate level associated with key constructs of interest. Theories can be applied at different levels and it is important to specify a priori which level is appropriate given the focal unit of the study, and specify constructs accordingly. If a theory is applied at a level that differs from its origin, careful attention must be paid to the underlying assumptions of that theory in order to determine to what extent key constructs and relationships are generalizable across levels. For instance, while resource-based theory (Wernerfelt, 1984) explains the effects of firm-level heterogeneity in
resources and capabilities on firm competitive advantage, application of the same theoretical arguments to individual (e.g., executive) or country levels may not be as straightforward. Whereas precise articulation of the level of one’s constructs is an important priority in all organizational research regardless of the number of levels involved (Klein, Dansereau, & Hall, 1994), it is paramount in multilevel research because of the possible “fallacies of the wrong level” (Rousseau, 1985, p. 5).

Level of measurement refers to the actual source of the data at the time of measurement and should correspond to the theoretical level of constructs in order to increase the variability predicted by the theory. For instance, if the theory specifies within-group heterogeneity (e.g., subsidiaries within firms), data collection should be conducted at the subsidiary level in order to ensure conformity with the theory and preserve the heterogeneity of the data within groups. Testing such theories would be best accomplished by (a) using measures that (like the theory) highlight the position of each individual subsidiary relative to the MNC and (b) maximizing within-group variability (Klein et al., 1994).

Finally, the level of analysis is concerned with the unit to which data are assigned and how data are treated during analysis. For instance, aggregating data from lower to higher levels reduces variability, thereby influencing correlations and regression coefficients, and may possibly alter the meaning and character of the data themselves (Rousseau, 1985). Disaggregation of data, on the other hand, exaggerates sample size and may lead to either too high or too low probability of committing type I errors (Snijders & Bosker, 1999). The level of analysis should be aligned with the level of theory and measurement in order to appropriately assess the nested sources of variability. In the analysis of complex multilevel data, it is informative to take account of the variability associated with each level of nesting. Recent advances in multilevel analysis allow researchers to account for the variability at different levels and to analyze the data at the level of theory and measurement (Raudenbush & Bryk, 2002; Snijders & Bosker, 1999).

**Multilevel Issues in M–P Research**

**Hierarchical Nesting**

Organizational entities reside in nested arrangements and more complete models of organizational phenomena must account for this nested structure, both theoretically and empirically. Within most domains of organizational/
firm research the structure is (typically) hierarchically nested such that higher-level units encompass those at lower levels. The importance of identifying nested structures lies in the fact that observations within higher-level units are more similar than across those units. Because lower-level units share common features and influences from the higher-level units, they are not independent. For instance, while there is variability between MNCs in terms of performance, additional variability will also exist between subsidiaries within an MNC. At the same time, multiple subsidiaries operating within the same MNC will share many governance and management practices. Therefore, subsidiaries are, by definition, nested, albeit imperfectly, within firms (MNCs). By the same token, MNCs are nested within institutional structures, such as countries and industries. For instance, multiple MNCs located (HQ) in a particular country are exposed to the same or demonstrably similar institutional characteristics, such as legal and tax systems, factor endowments, and sociocultural norms. Moreover, MNCs will share industry-level influences, such as level of competition, barriers to entry, innovative dynamism, etc.

Despite the obviousness of the nested structure of MNCs most empirical M–P research fails to accommodate this into their models. Failure to account for the nested nature of MNCs and their subsidiaries will potentially lead to attribution errors if the source of variation is misattributed. Prior studies neither identify theoretically what higher/lower-level factors influence the M–P relationship nor do they account for the nested structure of the data. Typically, scholars sample in only one or very few countries and/or industries effectively assuming independence in structures or between units, which may be inappropriate. In the few studies that include multiple industries and/or countries, variability is typically assumed away by treating them as same-level, independent variables, or by simply controlling for higher-level factors through use of industry or environmental dummies. We will return to this in the subsequent discussion of levels of analysis in M–P research.

In most M–P research, the focal unit of interest is the firm, as scholars seek to explain MNC performance as a function of international activities. Accordingly, the norm has been to investigate firm-level factors as direct predictors (e.g., multinationality) or moderators (e.g., product diversification) of MNC performance. Yet, researchers may benefit from looking (at least) one level above (e.g., industry or country characteristics) and below (e.g., subsidiary or executive characteristics) the focal unit of analysis in order to identify potential factors at higher or lower levels that may influence the focal relationship(s). Such factors should be identified by
integrating theories at different levels and paying careful attention to the assumptions and boundaries of such theories. Specification of the nature of such cross-level influences, either as direct or moderating, may then lead to interesting and new research propositions.

One way of depicting the nested structure of the M–P phenomenon is as follows. The lowest level 1 is the subsidiary level or executive level, which is nested in the MNC (level 2). Executives are nested directly in the MNC (not in subsidiaries). The MNC, in turn, is nested in both industry and country contexts (level 3). Industry and country levels are not hierarchically nested but cross-classified, since industries traverse different countries (industry is not nested within country or vice versa). It must be noted that subsidiaries themselves may be nested within different countries or even industries (e.g., in the case of highly diversified firms); however, we do not discuss these influences here as our main focus is on firm-level performance (Fig. 1).

Fig. 1. Typical Hierarchical Nesting Structure in M–P Research.

Levels of Theory and Potential Cross-Level Effects
Given the inconsistency of findings regarding the M–P relationship in international business research, it is important to examine the theoretical foundations of M–P research with particular attention to issues of levels. Whereas some studies attempt to integrate theories, it is not uncommon to find that constructs from different theoretical levels are mixed together without the specification of cross-level (moderating) relationships, and/or making predictions and testing propositions at a level that does not correspond to the underlying theory. This may, in part, explain the inconsistent empirical findings plaguing the M–P literature.

Table 1 provides an overview of the theories and perspectives that are often utilized in M–P research as well as key constructs from each theory.
<table>
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<th>Theory/Perspective</th>
<th>Key Arguments</th>
<th>Potential Moderating Constructs</th>
<th>Level of Measurement</th>
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| Internalization theory                 | • Profit maximization from internalization of intermediate markets across national borders  
• Benefits arise from avoidance of market imperfections  
• Cost arise due to increased internal coordinating | • Firm-specific intangible assets  
• Firm internal structure | • R&D intensity (Lu & Beamish, 2004); advertising intensity (Kotabe et al., 2002); patent count, etc.  
• MNC architecture, complexity, internal coordination costs (Bartlett & Ghoshal, 1989) |
| (Buckley & Casson, 1976, 2009)         |                                                                                |                                                                                                  |                                                                                        |
| Resource-based theory                  | • Superior performance rests in firms ability to gain above normal returns from exploiting strategic resources and firm-specific capabilities across international markets  
• Scope advantages | • Product diversification | • Herfindahl index or entropy measure (Palepu, 1985) of diversification |
| (Barney, 1991; Conner, 1991; Wernerfelt, 1984) |                                                                                |                                                                                                  |                                                                                        |
| Organizational learning theory         | • Firms establish subsidiaries in disparate host country environments to exploit and enhance their knowledge bases  
• Firms learn over time how to do business more efficiently in foreign countries | • Firm-level prior experience with internationalization  
• Pace and rhythm of foreign expansion | • Number of years since first FDI  
• Speed and irregularity of investment abroad (Vermeulen & Barkema, 2002) |
| (Johanson & Vahlne, 1977; March, 1991) |                                                                                |                                                                                                  |                                                                                        |
| Finance theory                         | • Internationalization increases exposure to macrolevel financial and political risks  
• Risk reduction via uncorrelated portfolio investments in diverse countries that are not economically integrated | • FDI portfolio diversification | • Number of foreign markets (Vermeulen & Barkema, 2002)  
• Diversity of FDI (Shapiro, 1978) |
| (Shapiro, 1978; Eiteman & Stonehill, 1979) |                                                                                |                                                                                                  |                                                                                        |
New institutional theory (Kostova, 1999; North, 1990; Scott, 1995)

- Institutional factors (formal and informal institutions) influence firm internationalization and performance
- Foreign institutional environments generate costs and benefits associated with internationalization
- Differences in national culture erect barriers to internationalization

Industrial organization theory (Hamel & Prahalad, 1985; Porter, 1985, 1990)

- The M–P relationship vary with industry characteristics, such as complexity, instability, and munificence

Upper echelons theory (Hambrick & Mason, 1984)

- Individual (CEO) and top management team (TMT) characteristics influence firm multinationality and performance
- TMT composition and diversity
- CEO demographic background and skills

Country-of-origin factors (endowed, human, and/or advanced)

- Country of origin institutional characteristics (political, legal, and/or societal)

Country level indicators, such as Kaufmann Indexes or World Competitiveness Report scores (Nielsen & Nielsen, 2008)
- Kogut and Singh (1988) index based on Hofstede (1980) national culture scores

- Indicators based on SIC industry codes (Aldrich, 1979; Dess & Beard, 1984)
- Industry concentration, number of competitors or measures of entry barriers

- CEO/TMT international experience (Carpenter, 2002) and/or nationality diversity (Nielsen & Nielsen, in press)
- TMT educational, functional, and tenure diversity (Barkema & Shvyrkov, 2007)
- CEO demographic characteristics Herrmann & Datta, 2002)
that may serve as potential moderators of the M–P relationship. It should be noted that by no means is this an exhaustive list of theories, constructs, or measurement issues, rather it serves as an illustration of the multilevel issues pertaining to M–P research.

**Firm-Level Moderators**
Drawing on firm-level theories, several studies have explored firm-specific factors as moderators of the M–P relationship. For example, building on organizational learning/internationalization process theory, Vermeulen and Barkema (2002) found that the pace of internationalization negatively moderated the M–P relationship. The same study also investigated the moderating effect of country scope, based on portfolio diversification theory. However, while the portfolio of firm foreign operations is defined at the firm level, it is composed of individual subsidiaries. The characteristics of this portfolio are, therefore, determined as the sum (average) or the diversity of the characteristics of individual subsidiaries (such as the political country risk of each subsidiary, opportunities for arbitrage based on differences in host country endowments, etc.).

Building on the resource-based view, others have explored moderating effects of firm-specific resources (e.g., R&D or marketing intensity) (Kotabe et al., 2002; Lu & Beamish, 2004). Finally, a range of scholars have tested the influence of the interaction between product and geographic diversification on performance (Geringer et al., 2000; Tallman & Li, 1996). However, potential moderators from different levels of theory are rarely considered in the M–P literature, and thus cross-level interactions constitute a particularly ripe area for future research.

**Country-Level Moderators**
In the international business literature, institutional theory has often been employed to examine both constraints on MNC decision-making, and, to a lesser extent, how institutional factors can help MNCs overcome environmental uncertainty. Although researchers have considered home and host country endowment to be important (Buckley & Casson, 1998; Tse, Pan, & Au, 1997), most of this work is oriented specifically toward the entry mode decision rather than firm internationalization in general (Werner, 2002). Moreover, majority of existing studies focus on the degree of similarity between home and host country business environments and suggest that differences in contextual settings create exponential complexity and inflate costs of doing business abroad (Kostova & Zaheer, 1999).
Extant research has primarily focused on the host country characteristics or the distance between home and host countries, while the influence of specific home country attributes has been largely neglected. This is a critical omission given that country-of-origin factors arguably exert important influences on MNC strategies (Kostova & Zaheer, 1999). The home country environmental context may, indeed, constitute a core component in interpreting the mixed findings regarding the proposed M–P relationship (Bausch & Krist, 2007; Hennart, 2007). Given the limited validity of extrapolating from one context to another when making predictions about firm internationalization, the applicability of theoretical arguments and empirical findings across countries has yet to be examined (Wan & Hoskisson, 2003; Wan, 2005). For instance, it is likely that while firms from particular countries (with particular institutional attributes) may gain from multinationality, firms from other countries (with different institutional conditions) may incur losses from internationalization. Yet, few empirical studies have compared the benefit and cost trade-offs attributable to internationalization that firms from different countries face when going abroad.

Most existing studies have been conducted in a small number of developed countries, notably the United States, Japan, Germany, and UK, paying inadequate attention to the role of the home country institutional environment in which firms are embedded. The few studies that utilize cross-country data unfortunately model home country influences as dummies, or split the sample into broad categories. For instance, Geringer et al. (1989) found a positive significant relationship between internationalization and performance only when they separated their data by region (United States vs. Europe), suggesting that the size (and possibly the direction) of the effect is significantly affected by the country environment context. Bausch and Krist’s (2007) meta-analysis found that American, and to a lesser extent European, companies benefit more from internationalization than do their Japanese counterparts. Elango and Sethi (2007) showed the M–P relationship to be positive in small open economies and U-shaped in large economies with modest trade. Finally, Wan and Hoskisson (2003) discovered that firms in more munificent home country environments enjoy performance improvements when they internationalize, whereas those in less munificent environments do not gain substantial performance benefits. Hence, although scant, empirical evidence seems to support the salience of country-of-origin factors in the M–P relationship.

Although a limited number of studies point to the fact that home country environment matters for the M–P relationship, they fail to explain why. Among the few studies that explicitly theorize and model home country
effects, Wan and Hoskisson (2003) drew on institutional theory to hypothesize that country-of-origin may influence a firm’s ability to extract value from its international activities. However, in their study, country of origin was modeled by splitting the sample according to munificence, based on various combinations of institutional factors. While an important initial step, their approach did not allow for teasing out what specific institutional characteristics of the home country environment matter and why.

Summarizing extant research, Jackson and Deeg (2008, p. 540) concluded that “the view of institutions within IB tends to be ‘thin’, utilizing summary indicators rather than detailed descriptions, and thus approaching institutions as uni-dimensional variables that impact on particular facets of business activity.” Future research may benefit from investigating more closely what specific aspects of country-of-origin normative, regulative, and cognitive institutions influence the M–P relationship, and to what extent such influences work in unison (complementary) or opposite directions (supplementary), thereby either strengthening the combined effects or potentially cancelling each other out. As an example, Nielsen and Nielsen (2008) revealed that home market size positively moderated the relationship between degree of internationalization and performance, whereas home country labor efficiency had the opposite moderating effect. We strongly advocate theoretical and empirical work that explicitly considers the whole institutional configuration of host and home countries in order to avoid misspecifications owing to potential interactions with other complementary institutions.

Drawing on new institutional theory and classical economics (North, 1990; Scott, 1995), it is possible to examine to what extent endowed (e.g., access to natural resources, labor supply, and energy sources), human (e.g., educational quality and number of R&D personnel), and/or advanced (e.g., capital, technical, and physical infrastructure) factors influence a firm’s ability to extract superior value from multinationality. Simply summing and averaging these factors does not provide meaningful insights into their potential individual and combined effects on the M–P relationship. Similarly, political, legal, and societal institutional factors consist of a number of important variables (e.g., rule of law, quality of judiciary system, efficiency of banking system, civic norms, etc.) that are likely to influence the costs and benefits of firm internationalization and thereby affect the M–P relationship. Such institutional influences on the firm cannot be ignored when theorizing, measuring, and analyzing the M–P relationship because such effects are nonvoluntary conditions shaping the strategic opportunities of the firm. To provide theoretical explanations for the observed variation in the M–P
relationship between countries, it is paramount to explore cross-level interactions of such (home) country-level factors on the M–P relationship.

**Industry-Level Moderators**

An organization’s industry environment constrains and shapes a firm’s activities and performance (Aldrich, 1979; Dess & Beard, 1984). Yet, in the M–P literature, industry effects are typically modeled as controls – e.g., either through industry dummies or through variables describing industry profitability (Goerzen & Beamish, 2003; Hitt et al., 1997) or industry growth (Tallman & Li, 1996). However, the possible cross-level moderating effects of industry factors on the M–P relationship have rarely been considered. For example, although, scholars have argued that the nature and shape of the M–P relationship is different for service firms compared to manufacturing firms (Capar & Kotabe, 2003; Contractor et al., 2003; Goerzen & Makino, 2007), the broad distinction between manufacturing and service industries does not explain why the M–P relationship differs between the two types of industries. Furthermore, Contractor et al. (2003) also demonstrate that between-industry differences in performance exist within the service sector.

Although these approaches are useful to illustrate the importance of industry effects in general, they fail to explain to which specific industry characteristics such effects are attributable. However, industrial organization and strategy literatures provide us with some theoretical insights. For example, industrial organization theory highlights market deficiencies, such as entry barriers or industry competitiveness, which potentially enable firms to earn economic rents via exploitation of their international market power (Hamel & Prahalad, 1985; Porter, 1985). Similarly, the strategy literature (Dess & Beard, 1984) helps us understand aspects of the dimensions of the industry environment, such as complexity, dynamism, and munificence, which are likely to impact on the M–P relationship in that some may enhance, while others may inhibit, the extent to which firms can extract benefits from multinationality.

**Executive-Level Moderators**

Although most scholars recognize the importance of individuals and teams in strategic decision-making, the IB literature is conspicuously silent on their potential influence. Little prior work exists on the role of executive decision-making in the firm internationalization process (Buckley, Devinney, & Louviere, 2007; Hitt et al., 2006). This is surprising given the growing attention to executive effects on firm strategy and performance. For
instance, upper echelons theory (Hambrick & Mason, 1984) argues that executive characteristics influence strategic decision-making and ultimately firm performance. Demographic background characteristics and prior experiences have been shown to exert significant influence on firm strategic choices, including firm degree of internationalization (e.g., Barkema & Shvydkov, 2007; Sambharya, 1995), formation of international alliances (Eisenhardt & Schoonhoven, 1996; Reuber & Fischer, 1997), and foreign market entry mode (Herrmann & Datta, 2002; Nielsen & Nielsen, in press).

Moreover, strategy scholars propose an interaction effect between executive characteristics (e.g., international experience) and firm internationalization on performance (Carpenter, 2002; Daily, Certo, & Dalton, 2000). Theoretically, these studies are grounded in the upper echelons perspective and the behavioral theory of the firm with explicit focus on executive effects on performance, thus modeling internationalization as a moderator of this relationship. However, it is possible to argue the opposite way that executive characteristics moderate the M–P relationship. Executives with international experience or foreign national backgrounds are better equipped with skills and knowledge relevant to pursue international activities and are, therefore, likely to make decisions pertaining to internationalization that result in superior performance.

Fig. 2 below presents the above-discussed cross-level influences of factors at different levels on the M–P relationship. While this model is not

![Fig. 2. Potential Cross-Level Moderators of the M–P Relationship.](image)
exhaustive, it serves as an illustration of potential multilevel influences that may guide future M–P research.

Level of Measurement

Operationalization of multinationality has been approached in a variety of ways in the M–P literature, ranging from a simple count of the number of countries (or even regions) the firm serves (e.g., Grant, 1987; Lu & Beamish, 2004) to the ratio of foreign sales to total sales (FSTA) or foreign assets to total assets (FATA) (e.g., Ruigrok & Wagner, 2003) – to more complex measures such as Herfindahl indexes of geographical dispersion (e.g., Geringer et al., 2000). Some authors have used a multidimensional composite index measure that integrates the relative size of a firm’s foreign investments and its spread across heterogeneous countries (e.g., Sullivan, 1994; Gomes & Ramaswamy, 1999). Measuring different dimensions of multinationality, these operationalizations often suffer from contradictions between theory and measurement (Hennart, 2007). For instance, while FSTS and FATA may be used as proxies for the amount of international involvement, they say little about the dispersion (or scope) of foreign activities, as sales and assets may be located in a small number of geographically (and culturally) close countries. Since extensive reviews of measurement issues in the M–P literature exist (e.g., Annavarjula & Beldona, 2000; Bausch & Krist, 2007; Verbeke & Brugman, 2009), we focus the following discussion on potential mismatches between levels of theory and measurement.

The M–P literature is fraught with studies that theoretically argue costs and benefits related to spreading of risks and arbitrage/leverage of resources among subsidiaries, while measuring multinationality as firm-level foreign sales or foreign assets ratios. Such treatment does not reflect the diversity in characteristics of each subsidiary and constitutes a mismatch between the level of theory and measurement. Only recently have scholars begun to advocate the distinction between degree of internationalization and degree of international diversification (or country scope) that more accurately reflect the underlying multilevel nature of the multinationality construct (e.g., Nielsen & Nielsen, 2008; Verbeke & Brugman, 2009). We argue that multinationality cannot be measured accurately without looking at the portfolio of subsidiaries. It is paramount to consider not only the number of countries and foreign subsidiaries, but the idiosyncratic country characteristics of each subsidiary within the portfolio. Specifically, researchers must take into account the diversity in institutional characteristics of the
countries in which the subsidiaries are based (e.g., country risks measured by Kaufman indexes) or diversity in culture (e.g., cultural distance measured by the Kogut/Singh index) in accordance with the underpinnings of the underlying theory.

Although the performance of an MNC is at least partially determined by the performance of its individual subsidiaries, the key construct of interest is the profitability of the entire MNC (i.e., the returns that arise not only from the performance of individual subsidiaries but also from additional firm-level benefits such as gains from scale/scope advantages, knowledge synergies, patents, etc.). At the same time, aggregating performance to the firm-level ignores variability in subsidiary performance that may cancel each other out. Most studies assume similarity and independence between subsidiaries and use aggregate firm-level performance to approximate the dependent variable. For instance, the recently advanced S-curve hypothesis builds on learning theory to argue that experiential learning, over time and from diverse country environments, will influence the cost and benefits at various stages of internationalization and suggests an optimal degree of internationalization. However, performance implications of multinationality may not be a matter of finding the optimal point of internationalization, but rather of developing the right portfolio of subsidiaries in order to optimize the mix of resources and capabilities that determine overall MNC performance. As a result, aggregated firm-level performance measures may be inadequate at gauging the true value-added of multinationality.

In a similar vein, it is important to carefully specify, operationalize, and measure the moderating constructs at their level of theory. For instance, institutional constructs should ideally be measured with data collected from sources that preserve the country-level variability, such as the World Competitiveness Report or Kaufman Indexes. Similarly, industry-level factors should be operationalized and measured at the level of industry in order to capture industry variability (see, for instance, Dess & Beard, 1984, for measurement of industry complexity, munificence, and dynamism). If an aggregation of firm-level data to industry or country level is used, it is pivotal to justify such aggregation and specify its implications for theory and analysis. Finally, executive characteristics should be collected at the individual level and measured either at the individual (e.g., CEO) or group level (e.g., TMT) according to the underlying theory (for a discussion of upper echelons multilevel issues, see Cannella & Holcomb, 2005).
Many, if not most, social science data have nested or hierarchical structures. Although the introduction of multilevel modeling to management research is a fairly recent phenomenon, such methods offer great advantages over traditional techniques when dealing with nested data. Traditionally, multilevel data have been dealt with in two ways (Raudenbush & Bryk, 2002): disaggregation to lower levels, or aggregation to higher levels. The first approach is to disaggregate higher-level variables to the lower level. That implies that, for instance, industry and country characteristics are assigned to the firms, and analysis is conducted at the lower (e.g., firm) level. This approach is problematic as firms within countries or industries have the same values for country/industry variables, thereby violating the basic assumption of independence of observations that is paramount for the classical statistical techniques (e.g., simple OLS regression). The second alternative is to aggregate data from the lower- to the higher-level units (e.g., from subsidiary to the firm level) and conduct analysis at the higher level. Yet, this approach implies a loss of data (information) at the lower level, which may constitute an important source of variation in the data. Consequently, relationships at the higher level may be stronger and differ from the relationships between the nonaggregated variables. Both aggregation and disaggregation can lead to “ecological fallacies,” that is making a conclusion at the wrong level that does not necessarily hold as the level of primary (theoretical) interest.

One such fallacy is neglecting to account for the nested structure of the data and thus violating the independence assumption. For instance, firms within certain industries are more similar than those across industries, and hence they share characteristics such as industry growth, profitability, or R&D intensity, which are repeatedly reported for all firms within each industry. Another potential problem is aggregation and trying to generalize at levels such as manufacturing versus service, or knowledge-intensive versus capital-intensive industries, thereby assuming firms within such categories to be homogeneous, e.g., a bank is similar to a tourism company as both can be characterized as “service firms.” This approach ignores the lack of variation between different types of knowledge intensiveness of service or manufacturing industries, and fails to account for the possible variation arising from specific industry characteristics.

One of the most often committed errors in M–P research is aggregation of time series into average values. Although, researchers argue for learning
effects that develop over time, they invariably aggregate time series into single values (e.g., Capar & Kotabe, 2003). Such an approach leads to a loss of information and to failure of testing the actual relationship proposed (e.g., the S-curve hypothesis of variation in the M–P relationship over time). Another potential problem is that while the true association between the variables may be positive, the empirical findings for the relationship between the aggregated values are negative (see Snijders & Bosker, 1999, p. 14).

With hierarchical linear models (HLM), each of the levels that are specified theoretically and measured accordingly is formally represented by its own submodel for each level. These submodels express relationships among variables within a given level, and specify how variables at one level can influence relationships occurring at another. In this way, HLM offers three substantial advantages over traditional statistical models (Raudenbush & Bryk, 2002, p. 7): (1) improved estimation of effects within each unit; (2) formulation and testing of hypotheses about cross-level effects; and (3) portioning the variance and covariance components among levels (e.g., decomposing the covariation of variables at the firm level into within- and between-industry and/or country components).

CONCLUDING REMARKS

The much-debated relationship between multinationality and performance constitutes an organizational phenomenon, which unfolds within complex and dynamic social systems, spanning multiple levels of theory and analysis. Yet, in the IB literature, these systems are often divided into country-, industry-, firm-, subsidiary-, and team- or individual-level subparts, each part the providence of different disciplines, theories, perspectives, and approaches. As a result, the M–P literature is largely based on single-level theorizing, superficial conceptualizations, and poor measurements of key constructs, often leading to critical mismatches between theory, measurement, and analysis. Not surprisingly, this has led to a theoretically fragmented and empirically inconsistent body of literature with few attempts to bridge disciplinary divides and integrate theories across levels. This paper has made the case for careful attention to multilevel issues of theory, measurement, and analysis in the pursuit of more coherent analytical models that may enhance our understanding of the important M–P relationship.
Despite recent theoretical advances in the M–P literature, such as the S-curve or three-stage theory (Contractor et al., 2003; Lu & Beamish, 2004), there is still plenty of room for improvement. Although these theories take into account simultaneous influences of costs and benefits associated with firm internationalization (over time), potential influences of factors at different levels are rarely considered. Recent studies have included several moderators in their models; however, these are predominantly at the firm level. Moreover, despite drawing on arguments from different theories, such as learning and internalization theories, little attention is directed at the integration of these theories in terms of levels of theory, measurement, and analysis. Yet a coherent theory of the effects of MNC international activities on performance must account for the inherently multilevel nature of the phenomenon and recognize that MNCs are nested within industries and countries. Moreover, while multilevel research typically looks at levels above the dependent variable and specifies cross-level effects of higher-level factors on lower-level relationships, the M–P literature provides ample opportunity to look at levels below the firm (e.g., subsidiary and executive) as well.

This paper has pointed at the need for further theoretical and empirical considerations of multilevel issues. Specifically, we suggest that paying careful attention to levels of theory, measurement, and analysis may help advance the M–P literature and perhaps resolve the empirical confusion. In particular, we strongly advocate that future research explores some of the cross-level moderating effects outlined in Fig. 2 above. Doing so may help advance theory development and empirical research in the field; however, it is important to emphasize the importance of adequately specifying, operationalizing, measuring, and analyzing these relationships in accordance with theory. As such, perhaps the most important first step in the pursuit of a more complete understanding of the M–P relationship is to develop a coherent multilevel theory, which specifies the interdependencies and interactions of key variables at different levels, as well as across these levels. Such a theory is likely to be multidisciplinary as it will involve insights from institutional and industrial economics, organizational theory, and behavioral theory, as well as considerations from upper echelons theory and social psychology. Finally, careful attention to measurement issues and application of analytical methodologies that explicitly take into account multilevel issues will greatly enhance future M–P research.

In conclusion, we strongly feel that despite a rich tradition, research on the M–P relationship is not running out of steam, rather exciting new avenues lie ahead. Greater attention to levels’ issues will increase clarity,
testability, comprehensiveness, and creativity of future M–P research. The application of multilevel thinking to the M–P relationship holds great promise for advancing this literature both theoretically and empirically, and provides researchers with new, interesting, and potentially groundbreaking insights into what continues to be an important issue to resolve: to what extent and under what conditions do firms benefit from international activities?

NOTES

1. Excess value is often measured as the log of the ratio of the firm’s actual value to its imputed value ratio of the firm’s actual value to its imputed value (Berger & Ofek, 1995).

2. It should be noted that WCR data, Kaufmann and Hofstede/Kogut-Singh indexes are aggregated measures yet these measures are well established and aggregation to country level is typically based on large samples with application of rigorous methodologies.

3. Institutions may also be operationalized and measured at the industry level; however, consistent with the application of institutional theory to the IB literature, we only discuss its application at country level.

4. Most firms span multiple SIC codes, and hence, industry specifications are often very imprecise.

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NONLINEAR INTERNATIONALIZATION: A NEGLECTED TOPIC IN INTERNATIONAL BUSINESS RESEARCH

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ABSTRACT

International business (IB) research has mostly concentrated on two forms of internationalization: the gradual/step-by-step approach, and the “international new venture”/“born global” approach. The existence of nonlinearity – substantial “jumps” in international intensity – has received relatively modest attention. This paper addressed nonlinear internationalization processes: partial and complete de- and re-internationalization and the internationalization of born-again globals and born-again internationals. It concludes that nonlinear internationalization is neither an irregular deviation nor an exceptional case of linear internationalization but that linear internationalization is an exceptional case of nonlinear internationalization.
INTRODUCTION

Although internationalization processes have been actively researched for more than five decades, a serious research gap still exists. Even today, the vast majority of the literature still views internationalization as a gradual, step-by-step process of “increasing involvement in international operations” (Welch & Luostarinen, 1988, p. 36). However, in the 1990s researchers started to examine cases where firms internationalized very quickly, skipping many of the steps thought necessary for success. Such “international new ventures”/“born globals”/“born internationals” highlighted serious theoretical gaps in existing internationalization theories that did not go unnoticed. Moreover, several authors – such as Axinn and Matthyssens (2002), Bell, McNaughton, and Young (2001), Chetty and Blankenburg Holm (2000), Macharzina and Engelhard (1991), Oesterle (1997), and Pedersen, Petersen, and Benito (2002) – have acknowledged the need to study other kinds of enterprises and internationalization processes, as the current literature cannot explain the full reality of all firms’ internationalization.

In this paper we focus on the conception of nonlinear internationalization; a process characterized by substantial increases and decreases in internationalization activity. By nonlinear internationalization we mean cases that encompass the partial and complete de- and re-internationalization and the internationalization of born-again globals and born-again internationals. The paper also gives a short overview of three extreme types of linear internationalization processes – slow, gradual, “the Uppsala style,” fast, “the born global style,” and “the late starter style” (fast after years of concentrating on the home market) – and brings out their problems. In addition to drawing some insights from the literature, it also uses case study evidence from four Estonian companies. Finally, the paper ends with some research suggestions.

THE ESSENCE AND PROBLEMS OF LINEAR INTERNATIONALIZATION MODELS

Traditional (Slow) Internationalizers

Many researchers – including the supporters of the Uppsala (or U-) model, developed by Johanson and Vahlne (1977, 1990), Johanson and Wiedersheim-Paul (1975), and Vahlne and Johanson (2002), among others,
and the authors of innovation-related internationalization (I-) models (for an overview, see Bilkey, 1978; Morgan & Katsikeas, 1997) – have stated that the internationalization process is often slow and additional market commitments are made in small steps (Johanson & Vahlne, 1977; Morgan & Katsikeas, 1997; see also Fig. 1). This means that after concentrating on the domestic market for several years, internationalization begins with entry into the closest markets or those that are comparatively well known or similar to the home market. In other words, firms are supposed to enter new markets with successively greater psychic distance: more different language,
culture, political systems, education, and industrial development levels (Johanson & Vahlne, 1990).

The U- and I-models agree that internationalization is also gradual in terms of foreign operation modes. According to the Uppsala model, enterprises do not, at first, have any regular export activities; they start exporting via independent representatives or agents; next they establish overseas sales subsidiaries; finally, they set up production/manufacturing units (Johanson & Wiedersheim-Paul, 1975). In I-models, the number of steps varies – e.g., Bilkey and Tesar (1977) argued for six phases, while Reid (1983) identified eight. Although some authors (e.g., Johanson & Vahlne 1990, 2003; Wiedersheim-Paul, Olson, & Welch, 1978) have acknowledged that all enterprises do not have to follow such routes, this is seen as an exception rather than the rule.

**International New Ventures/Born Globals/Born Internationals**

Since the 1990s, international new ventures/born globals and other fast internationalizers have received more attention. For these companies, the world is their marketplace (McDougall, Oviatt, & Shrader, 2003) and they begin with a proactive international strategy (Lopez, Kundu, & Ciravegna, 2009) despite being (or perhaps because they are) young and small, and despite having constrained resources, operating in volatile markets, and, by definition, possessing little or no foreign market experience (Oviatt & McDougall, 1994). Some firms even enter foreign countries before selling anything on their home market (Bell, 1995).

Fast internationalizers have been defined differently. Kuivalainen, Sundqvist, and Servais (2007) claimed that true born globals should internationalize during the first three years after establishment, enter culturally distant foreign countries and achieve at least a 25-percent share of turnover from abroad during this period. Lopez et al. (2009) stated that they should reach outside their region soon after establishment. Gabrielsson, Sasi, and Darling (2004), in turn, emphasized that they should generate at least half of total sales from outside their own continent within 15 years since starting operations. So it has not been agreed how many markets such firms should enter in a certain period, how soon since establishment they should expand to foreign markets, or which countries and continents they should prefer. Still, most authors have agreed that these enterprises “leapfrog” into internationalization instead of moving cautiously through incremental steps (Oviatt & McDougall, 1994). In addition, there is no consensus as to which
entry modes such firms should use. According to Oviatt and McDougall (1994) it is not necessary that they even have to own foreign assets and that instead of sales or production subsidiaries, they may form strategic alliances.

This research stream has been very popular in the past two decades, although the authors have still not agreed on definitions and classifications. Moreover, they still prefer to study successfully developing firms in their first years since establishment with little attention being paid to their problems or their activities after their phase of fast expansion.

**Late Starters**

Late starters are companies that have stayed domestic for a long time while their competitors, customers, suppliers, and intermediaries became highly international (Johanson & Mattsson, 1988; Reid & Freeman, 2006) and then internationalized faster than traditional/slow internationalizers. Several reasons may exist why these firms did not try to internationalize right from the beginning of their establishment (Chetty & Blankenburg Holm, 2000; Wilkinson, Mattsson, & Easton, 2000): the domestic market offered enough growth opportunities; they were not internationally competitive; they lacked production capacity, knowledge, experience, or financial, human, or other resources for entering foreign markets; they were not aware of international opportunities; their products were not significant for international firms in their network; or trade barriers existed for their products.

For late starters, markets with close psychic distance may be difficult to enter as the competitors have already entrenched themselves, making it more advantageous for the late starters to begin their internationalization in more distant markets. Late starters are also at a disadvantage in their close markets because their competitors may possess more knowledge about these markets and be better integrated into the existing networks in operation there (Chetty & Blankenburg Holm, 2000).

The literature on late starters is relatively scarce. For example, we do not know what happens after these firms begin their internationalization, how they should select their markets, and which entry modes they should use. As might be expected, the literature on linear internationalization has concentrated on the first two types of international expansion leaving the late starters out.

A selection of the criticisms of the U- and I-models and the literature on international new ventures/born globals/fast internationalizers are presented
in Table 1. Late starters were not added to the table as they have not attracted considerable research attention yet.

### THE ESSENCE OF NONLINEAR INTERNATIONALIZATION

Although a large percentage of the international business literature has concentrated on slow/gradual or born-global type internationalization with linear trend lines (depicted in Fig. 1), this does not mean other forms of internationalization do not exist; particularly in light of the fact that it is difficult to find companies that have never deviated from the international growth paths that the traditional theories expect. For example, some companies have suddenly decreased exports to some markets; some have closed down foreign subsidiaries, while some have returned to some markets or reopened subsidiaries again. This means that their internationalization is nonlinear – it cannot be depicted with a linear trend line. The following sections concentrate on three types of nonlinear internationalizers – de-internationalizers, re-internationalizers, and born-again globals/born-gain internationals.
De-internationalizers

De-internationalization may take several forms (see Fig. 2): it means not only withdrawing completely from all foreign markets or a specific market, but also reducing the depth or breadth of operations (for instance, decreasing ownership in a foreign joint venture or laying off some staff involved in international operations) and switching to entry modes with smaller resource commitments; for instance, divesting and starting to export instead of engaging in local production (Calof & Beamish, 1995; Benito & Welch, 1997).

De-internationalization may occur at any stage of internationalization, but it is especially likely in the earlier stages (Welch & Wiedersheim-Paul, 1980; Welch & Luostarinen, 1988), and may affect both slow and fast internationalizers. For example, studies (Oviatt & McDougall, 1995; Wickramasekera & Bamberry, 2003) have shown that some international new ventures/born globals may face problems because of their newness, inexperience, limited access to resources and networks and, as a result, de-internationalize.

De-internationalization may be voluntary or forced (Benito & Welch, 1997). Forced de-internationalization may be caused by expropriation, nationalization, or economic boycotts (Akhter & Choudry, 1993), while voluntary de-internationalization may be triggered or influenced by increased local or decreased foreign demand (Welch & Wiedersheim-Paul, 1980),

Fig. 2. Some Examples of De-internationalizers.
changes in the company’s long-term objectives (Akhter & Choudry, 1993), and its overall commitment to international operations (Benito & Welch, 1994). Thus, de-internationalization is not always a failure; it may result from small and gradual adjustments or from massive restructuring (Benito, 2005).

Although it is evident that during its internationalization process, almost every company may have to de-internationalize at least partially (e.g., reduce its exports to some markets), this has not received as much research attention as linear internationalization processes. Moreover, it is not uncommon for researchers to either overlook or completely ignore de-internationalization by only taking into account the firm’s overall exports, export share, or the number of foreign subsidiaries, and not such data by market, product category or product line.

Re-internationalizers

Few studies concentrate mainly on re-internationalization: the case of reentry to or restoration of resource commitment to specific markets from where the firm has previously exited, or where it had reduced its involvement, as well as entering different foreign markets instead of those that were exited and using entry modes with a higher resource commitment than after de-internationalization. However, there are studies that give at least some insight into the issue. Although they have not paid considerable attention to re-internationalization, several authors – Akhter and Choudry (1993), Chetty and Campbell-Hunt (2003), Kutschker, Bäurle, and Schmid (1997), Orava (2005), and Pauwels and Matthyssens (1999) – have acknowledged that de-internationalization may be followed by a phase of re-internationalization. These studies note that re-internationalization may be influenced by exit strategies, improvements in foreign market or industry conditions (Akhter & Choudry, 1993), network relationships (Hadjikhanı, 1997), and reentry costs (Roberts & Tybout, 1997). However, re-internationalization is not a topic that has been studied systematically.

It is also not clear which entry modes or countries such companies should prefer. Only Orava (2005) claimed that re-internationalization might involve modified service offering or market entry mode, while Welch and Welch (2009, p. 568) stated that the exit from international operations should be followed by a time-out period, and then by a process of international reentry with “successfully renewed international operations.”
Fig. 3 shows that re-internationalization may be partial or complete, slow or fast, and that during its existence, a firm may de- and re-internationalize several times. Moreover, after re-internationalization, some companies may become even more international – e.g., enter more markets, achieve a higher export share, or establish more foreign subsidiaries – than they were before their de-internationalization, but some may also become less international (these are not considered as re-internationalizers by Welch & Welch, 2009).

**Born-Again Globals and Born-Again Internationals**

Such firms have also experienced de- and re-internationalization, but this group has some distinct qualities, so it is viewed separately from the previous group. The term “born-again globals” was introduced by Bell et al. (2001) together with two synonyms: “reborn” or “resurrected globals.” These terms apply to those firms that have been international, but for some reason have ceased their international activities for some time (10 years or more), and then, after a “critical incident” – e.g., getting resources or accessing networks through a takeover, an acquisition, or following a customer – have begun to internationalize fast (Bell, McNaughton, Young, & Crick, 2003; the existence of critical incidents was also mentioned in Macharzina & Engelhard, 1991; Eckert & Mayrhofer, 2005, but they studied relatively stable internationalization phases followed by sudden leaps). Thus, they have also de-internationalized in their past, but they have
managed to re-internationalize, restoring their international activities or advancing them in other directions after a long period of having only domestic activities (see Fig. 4).

Such firms have not received considerable research attention. Hence, it is not clear into which markets they should (re)expand or on which foreign market operations they should concentrate after the period of local activities. It has also not been understood why they decided to remain domestic-market-oriented for at least 10 years after complete de-internationalization.

**FOUR CASES OF NONLINEAR INTERNATIONALIZATION**

To show the relevance of nonlinear internationalization and to demonstrate how such processes look like in real life, four case studies are discussed. For this paper, the case study method was selected because it allows combining previously developed theories and new empirical results, answering “how” or “why” questions, investigating complex contemporary phenomena within their real-life context, and developing new empirically valid theoretical and practical insights (Eisenhardt, 1989; Ghauri, 2004; Tsoukas, 1989; Yin, 1994). The task was not to examine as many companies as possible, but to characterize four internationalization processes and show that linear
internationalizers may become nonlinear internationalizers, and that some firms do not experience completely linear internationalization at all. Estonia was selected as its smallness – a population of 1.34 million – has led to its firms’ high dependence on foreign activities, and many of them have experienced nonlinear internationalization due to dramatic changes in the economic environment, but also several other factors. To show that such phenomena are not limited to a single industry, firm size, ownership type, or age, it was decided to select enterprises of different sizes and ages, from dissimilar industries, with different owners and internationalization patterns. The evidence was collected through several sources, including interviews, annual reports, local business papers and journals, and the companies’ homepages.

CASE STUDY EVIDENCE

Case 1: A Slow, Gradual Internationalizer Developed Into a De- and a Possible Re-internationalizer

Olympic Entertainment Group opened its first casino in 1993 and its first casino hotel in 1997. In 2002, activities in Lithuania and Latvia started (see Fig. 5). In 2004, it also expanded to Ukraine and in 2006, to Belarus. In 2007, it entered Poland and Romania and in 2008, Slovakia. At that time, Central and Eastern Europe’s gambling market grew faster than any other in the world. The firm’s growth was relatively smooth until the end of 2007: in 2001–2007, its turnover from all markets increased and new markets were entered regularly. Moreover, the shares of different foreign markets from the firm’s turnover also increased almost every year. In 2007, the company reported a net profit of 23.41 million EUR and a turnover of 158.97 million EUR.

From the beginning of 2008, the firm’s situation changed. In 2008, it had a net loss of 29.22 million EUR although its turnover increased to 178.19 million. In the fourth quarter of 2008, the Baltic gaming market contracted by 20 percent. The decline was even steeper in the first quarter of 2009: compared to the first quarter of 2008, the gaming markets contracted by 58 percent in Estonia, 36 percent in Latvia, and 26 percent in Lithuania. In the following quarters, the firm’s situation did not improve: in 2009, its turnover decreased to 108.73 million EUR and its net loss was 22.12 million EUR.

The firm’s losses can be partially explained by the weakening on the Polish, Ukrainian, and Romanian currencies against the Euro, the
obligation of Lithuanian and Estonian customers to register themselves when entering casinos, and indoor smoking bans in these countries. The firm’s situation also worsened in May 2009 when Ukraine’s minister of finance stopped the activities of all casinos because of a fire in a casino belonging to another company, so the firm had to exit the Ukrainian market.

Already in 2008, the firm implemented an extensive efficiency program: closed casinos with negative cash flows, shortened opening times, reduced salaries and the number of employees and slot machines. Still, the managers expect that after the crisis, the company’s market share and turnover will increase considerably.

It is evident that Olympic Entertainment Group would have been almost a perfect example of a slow/gradual internationalizer – until 2007, it entered markets with a successively greater psychic distance and the turnover from these markets also increased every year – but then, due to several unfavorable changes in the economic environment, the company deviated from the linear path. Its turnover continued decreasing in 2009 and it had to exit Ukraine. Still, in the future, it plans to increase its turnover from abroad again. So, partial de-internationalization may be followed by partial re-internationalization.

Fig. 5. The Turnover of Olympic Entertainment Group in 2001–2009 (Million EUR).
Case 2: A Late Starter Developed into a Nonlinear Internationalizer

Regio was founded in December 1989 as a map publisher. Until the end of 1999 it was completely domestic-market-oriented. In 1994 it started to develop digital maps and later it also became active in geospatial data, geographical information systems, location-based services, and mobile positioning middleware. At the end of 1999, it started developing the world’s first location-based solutions project with Ericsson, the world leader in such services. In May 2000, the firm introduced a positioning service for rescue calls known as Rescue Board that led to interest from overseas purchasers. Regio involved a strategic investor in order to internationalize and in September 2000 merged with a Finnish provider of e-business solutions, Done OY. However, by 2002, the Done OY division that included Regio went bankrupt and Regio’s ex-owner Teet Jagomägi repurchased the firm together with the division’s trademarks – Reach-U and Mgene Technologies – and the right to use Reach-U Solutions’ software.

Despite Reach-U’s bankruptcy, Regio was able to continue its cooperation with Ericsson. In 2002, Regio developed the world’s first solution for accessing maps via mobile phones and started to offer its services to dozens of countries. In 2009, the firm had customers in 20 countries and about 200 million people used its services (for its export data, see Fig. 6).

Regio can be classified as a late starter, as it remained completely domestic-market oriented for about 10 years, but then, due to cooperation with Ericsson and a short period of foreign ownership that gave it new trademarks and software, it expanded abroad relatively fast. Still, its internationalization after this expansion has not been linear: it has decreased exports to some countries and also exited some – Arab countries and Holland – for a year or two, but then reentered them again.

Case 3: A Born Global Developed into a Nonlinear Internationalizer

Asper Biotech – a leading Estonian biotechnology company – started operations in 1999 with four scientists. By 2000, the number of scientists had increased to 25 as the firm received an investment from SEAF CEE Growth Fund LLC (in 2008, foreign investors were bought out by their Estonian partners). In 2000, it began selling to customers in the United States and Korea, in 2001 to Taiwan and in 2002 to Japan, Canada; and Australia. Sales in the latter four countries have not been constant – in some years it has got some orders, while in others it has not sold anything. However, in
2003 its number of customers doubled and the firm began exporting to China, Kuwait, Israel, and Singapore. By 2009, it had managed to find customers from 42 countries, including Chile, Iran, Israel, Jordan, Brazil, South Africa, and New Zealand (for some export data, see Fig. 7).

Although the firm still has only 40 employees, it has managed to develop 17 DNA tests together with its partners from Europe, Northern America, and Asia. This firm is a true born global as it has been active already in Europe, Northern and Southern America, Asia, Australia, and Africa (four of these regions were entered within three years since its foundation), but, at the same time, it has experienced several periods of nonlinear internationalization, both in terms of market selection and export share fluctuation since 2001: only two years since its establishment. This company depends on relatively short-term scientific projects, so its turnover by countries fluctuates considerably. Asper Biotech entered and then completely exited several markets. It later reentered some of them – e.g., Sweden, Italy, Ireland, and Lithuania (in the latter two countries, exiting and reentry happened twice) – but it had also exited Korea and Latvia without reentering them. In addition to exiting some of its markets completely, this firm has also reduced its activities in other markets. Again, it has later
increased its activities in some of them – for instance, France, Germany, Denmark, and Holland. Such considerable deviations have also affected its turnover, exports, and export share, but not all of them very considerably: in 2000–2008, the latter fluctuated between 79.3 and 99.9 percent (in 2005–2008, between 87.0 and 90.3 percent).

Case 4: A Born-Again International as a Nonlinear Internationalizer

Hanza Tarkon is offering complete solutions in telecommunications, the automotive industry, energy, climate systems, industrial equipment, and consumer products. Its predecessor, the Telephone Factory Edisson and Co., was established in 1907. In 1913, the firm started exporting telephones to Russia. In 1924, the production of radio receivers for Latvia and Finland started. In 1929, Ericsson became one of its major shareholders. The firm began producing turn indicators for cars and started precision mechanics operations. In 1939–1940, it exported to 27 foreign countries, including Argentina, Brazil, and China.

In December 1940, the firm was nationalized and one year later most of its equipment and production, together with the company’s records, were
transported to Russia. In 1944, the factory was totally destroyed. In November 1944, Factory No. 89 was founded and subordinated to Moscow. Since 1948, the firm mostly produced flight recorders (black boxes) for the Soviet defense industry. In December 1992, it became a state-owned company RAS Tarkon employing up to 3,000 people. After Estonia regained independence, the market disappeared. In 1994, the production of black boxes ended. Tarkon had to completely reorientate itself and, at first, it filled small, unsolicited export orders, making very simple mechanical items for the Scandinavian and Western European markets. It had large debts.

Co-operation with Hallberg Sekrom Fabriks AB (since 2007, called HSF Gruppen AB) started in 1993. In October 1996, they bought 60 percent of RAS Tarkon and in 1999, the share of Swedish capital increased to 85 percent. Foreign ownership brought the ability to invest in new technology and renovate production facilities and Tarkon’s turnover and exports grew rapidly (Fig. 8). At first, it started exporting a large share of its products through its foreign owner, so its main market was Sweden, but in 2002, the latter started transferring its marketing activities to Tarkon. In 2001, the firm’s growth stabilized temporarily due to the slowdown in the electronics industry but this picked up again in 2003. In 2005, the company began actively looking for new foreign markets and entered the United States and

![Fig. 8. The Turnover of Hanza Tarkon in 2000–2008 (Million EUR; Sweden is on the left axis, all other markets are on the right axis).]
Germany. The export geography was further expanded a year later by entry into China and Brazil.

Hanza Tarkon is clearly a nonlinear internationalizer. It can be classified as a born-again international as it exported to a large number of countries before WWII, then was oriented at the Soviet home market, and after Estonia regained its independence, started internationalizing again. This re-internationalization has not been completely linear, either: it has exited two markets – Holland and China – and its exports to some other markets, including its main export market Sweden, have not grown linearly, either.

**CONCLUSIONS AND RESEARCH IMPLICATIONS**

Based on the literature review and the four case stories, it can be concluded that internationalization may begin in three different ways: (1) Many firms internationalize at first in line with the propositions in the U- and I-models – i.e., slowly, following several small steps, each of them increasing their foreign market commitment; (2) Many other companies follow the international new venture/born global path – i.e., they enter culturally and geographically distant markets and use foreign operation modes with high resource commitment, such as establishing foreign subsidiaries, almost at once after their establishment; (3) Some enterprises follow the path described in the literature on late starters – i.e., they remain for a considerable period of time in their home market without planning to internationalize, but then, usually following some critical incident such as a change in ownership or finding a global customer, they internationalize rapidly (in “born global” style).

However, firms start their international activities, this does not guarantee that their internationalization will remain linear. Three main types of nonlinearities can be detected: (1) During their internationalization process, some companies completely exit some or even all foreign markets, while some only reduce their commitment to foreign markets. (2) After such partial or complete de-internationalization, some firms re-internationalize again by reentering the countries from which they had previously exited, increase their resource commitment in some of these markets again (e.g., reopen a subsidiary in addition to exporting there), enter completely different markets, or use other entry modes. Such a re-internationalization may be followed by several de- and re-internationalizations. After such re-internationalization processes, some firms may become more international than they were before de-internationalization, while some others may
become less international. (3) In addition to de- and re-internationalizers described above, a third type of nonlinear internationalization exists, the born-again globals and born-again internationals. These firms also experience de- and re-internationalization, but it is assumed that in between these two processes they stay completely domestic for a long period.

From the four case examples, none internationalized in a completely linear manner. The closest situation to linear internationalization can be observed in the case of Olympic Entertainment Group – in 2001–2007, its turnover from all its markets increased and the firm continued entering new markets every year. A true born global (in terms of a high export share and activities on other continents), Asper Biotech exited its first foreign market and reduced exports to some others already on the third year after its establishment. The internationalization of a late starter Regio was linear for only the first two years of its internationalization. The born-again international, Hanza Tarkan, did not manage to grow linearly, either. It has decreased exports to some countries and completely exited two. The nonlinearities in these firms’ internationalization were caused by several outward (such as changes in the overall economic environment or their specific industry) and inward (such as changes in the firm’s strategy) factors and actors.

Although none of the case firms experienced completely linear internationalization during all years of their international development, the existing literature on slow/gradual internationalizers or international new ventures/born globals cannot be ignored. These research streams can help to explain how internationalization begins, why some companies prefer to select closest markets and entry modes with low resource commitment, while some others enter far markets and establish foreign subsidiaries first, and which factors may quicken and slow down internationalization. Still, based on these four cases, and also on the critique to the mainstream internationalization research, it can be suggested that more attention should be paid to nonlinearities.

Future research should include more firms from different countries, sectors, and industries and pay more attention to the nonlinear internationalizers’ selection of entry modes and markets; the reasons why in a specific country, sector, and/or industry, some firms de- and later re-internationalize while some others prefer to remain on all markets and not use any other foreign operation modes despite experiencing some difficulties; why some firms prefer to reenter some or all of their previous foreign markets after their de-internationalization but some others decide not to return there but to move to other markets instead; and why some
companies (re)expand to many foreign markets fast while some others prefer a slower pace of (re)internationalization, or even decide to limit their activities with the home market for several years. It should be also studied which internal and external factors and actors impact these decisions: which of them are more important in some cases, countries, sectors, or industries and less important in some others, and why. Moreover, more attention should be paid to classifications and definitions; e.g., when a firm can be classified as a partial de- or re-internationalizer – how much its turnover from a certain market should fluctuate.

In addition to collecting more case study evidence, some surveys could be also conducted and additional statistical information collected from annual reports about firms’ selection of and commitment to specific markets (including export shares and foreign operation modes) as it is not enough to calculate the overall export share. Such additional evidence would also support theory development. For example, it has to be explained to a wider audience that extreme linear internationalization types (on Fig. 1, lines “a,” “c,” “e,” and “g”) are almost inexistent in real business life, while other linear internationalization types (on Fig. 1, lines “b,” “d,” “f,” and “h”) can be also seen rather as relatively exceptional cases of nonlinear internationalization (especially when a specific firm’s internationalization for several decades is studied, not only a couple of years, as it is quite often done in studies on born globals), not the other way round.

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F. EMERGING MARKETS
DIASPORAS AS DRIVERS OF NATIONAL COMPETITIVENESS

Masud Chand

ABSTRACT

Diasporas can play a vital role in enhancing a country’s international competitiveness. They can act as catalysts to enhance human capital development in their country of origin (COO), use their transnational social networks in both the COO and country of residence (COR) as conduits for trade and investment, introduce COO culture and products in the COR, enhance the COO’s soft power and use their social networks to favourably affect the COO effect. In this paper, we examine the vital roles that modern diasporas play, as well as the issues that have led to their increasing importance. These issues are illustrated by looking at the experiences of two of the largest modern diasporas, the Chinese and Indian diasporas. The paper concludes by examining some of the emerging issues for diasporas in the fast changing current global environment, and discusses some of their implications for the diasporas themselves, their COOs and their CORs.

INTRODUCTION

Countries can greatly enhance their national competitiveness by leveraging their diasporas in different parts of the world. Members of the diaspora can
play a vital role in enhancing a country’s international competitiveness in a number of different ways. They can act as catalysts to enhance human capital development in their country of origin (COO), as well as use their transnational social networks in both the COO and country of residence (COR) as conduits for trade and investment. Other important ways in which diasporas can help include introducing the COO culture and products to the COR, and using their social networks to favourably impact the COO effect (Chand & Tung, 2010). However, the overall effectiveness of diasporas in driving national competitiveness is an understudied area of International Business. In this paper, we review the various ways in which diasporas have helped enhance the competitiveness of nations, their increasing importance in the highly connected global economy of today and the ways in which their role could change in the near future.

The existence of diasporas is not a new phenomenon. One of the first uses of the word *diaspora* was to refer to the population of Jews exiled from Israel in 607 BC by the Babylonians, and from Judea in 70 AD by the Roman Empire. Other important historic diasporas have included the Greeks and the Phoenicians. Historically, diasporas have been involved in setting up trade and cultural exchanges between their COOs and CORs. More recently, in the post-World War II period, diasporas from countries such as Taiwan, Israel and Mainland China have greatly helped their COOs by helping them attract foreign direct investment (FDI), developing institutional frameworks and facilitating their rapid industrialization. As globalization continues, albeit at a slower pace because of the 2008–2009 financial crisis, and as barriers to the mobility of capital and people come down, the role of diasporas in driving the relationship between their COO and COR continues to become more important. However, the forces that are driving globalization are also causing a change in the nature and role of diasporas, as well as their ties to both their COO and COR.

This paper begins by taking a brief look at the history of diasporas. We then discuss some of the contemporary developments that have led to their increasing importance for both their COO and COR. Next, we examine the multiple roles that diasporas play. It illustrates these roles through the example of two of the largest modern diasporas – the Chinese and the Indian diasporas. The changing role of diasporas is next examined though issues of particular concern to individuals within a diaspora, such as bicultural identity, regionalism, COR acculturation policies and rising living standards in their COOs. Finally, we conclude by examining how the changing role of diasporas could affect national
competitiveness and how different countries could best maximize the value of their diasporas.

**HISTORY**

‘Diaspora’ is derived from the Greek word meaning ‘a scattering or sowing of seeds’ and refers to the spread of a given ethnic group outside of their COO (Merriam-Webster’s Online dictionary, 2009; ‘Diaspora’). The term diaspora was traditionally used to describe the Jewish population exiled from the historic land of Israel in biblical times. The first mention of a diaspora created as a result of exile is found in the Bible: ‘thou shalt be a dispersion in all kingdoms of the Earth’ (Deutromony 28, p. 25, New International Version). However, the traditional definition of a diaspora as a ‘longing for an imagined homeland following a violent dispersal or some other cathartic event’ (Singh, 2003, p. 3) does not cover most modern emigrants. A more common interpretation best suited for our case would be the feelings associated with the experience of migration and the attendant anxieties of displacement, homelessness and a wish to return (Parekh, Singh, & Vertovec, 2003). This is especially the case if we accept Cohen’s argument (1997, p. 26) that a diaspora can emerge from a ‘growing sense of group ethnic consciousness in different countries, a consciousness that is sustained by, amongst other things, a sense of distinctiveness, common theory, and belief in a common fate’. The United Nations estimated that there were over 200 million migrants in the world in 2008 (UN, 2009). However, in this paper, we will be focusing mainly on the ‘knowledge diaspora’: those people who share similar characteristics such as being relatively well educated, financially well off and more likely to have extensive contacts in both home and host countries (Kapoor, Mehta, & Dutt, 2004).

**THE RISING IMPORTANCE OF DIASPORAS**

While diasporas have existed for thousands of years, their importance has recently been magnified because of a number of issues. The increasing mobility of people, the change from a one-way ‘brain drain’ to a multifaceted ‘brain circulation’, the rise of ethnic and national professional associations in different countries, and the emerging ‘war for talent’ as developing countries industrialize and attempt to leverage their diasporas as strategic assets have all contributed to their rising importance. We take a closer look at some of these issues in the following section.
The term ‘brain drain’ usually refers to well-educated people from developing countries migrating to developed countries (Creehan, 2001; Crush, 2002; Van Rooyen, 2001). The impact of globalization has greatly increased the mobility of people across geographical and cultural boundaries (Baruch, 1995; Iredale, 2001; Kooser & Salt, 1997; Shenkar, 2004). However, increasingly, the old dynamic of ‘brain drain’ is giving way to what Saxenian (2002) calls ‘brain circulation’ – people who had immigrated to developed countries moving back to their COOs.

A number of forces that came to the forefront in the 1990s helped reconfigure what was until then a bilateral brain drain into a multilateral brain circulation (DeVoretz, 2006). First, a robust economy in North America with an expanding IT sector fuelled the demand for highly skilled immigrants. This was filled largely, though by no means exclusively, by IT graduates from India. Second, the proliferation of dual citizenship policies allowed a class of highly skilled immigrants to move continuously between their erstwhile home country and the receiving country (DeVoretz & Pivnenko, 2004). In addition, the second citizenship often conferred even more extensive mobility rights. For example, naturalized Canadian citizens could enter the United States under a NAFTA visa created especially for trade related migration. Another major force that emerged in the early 1990s to accelerate ‘brain circulation’ was China’s relaxation of its exit requirements to allow highly skilled Chinese to leave for educational purposes, with the expectation that at least one-third would return to China. For its part, India instituted partial dual citizenship, partly in response to the concerns of its diaspora, and partly to encourage them and their descendants to reconnect to India, thus facilitating Indian ‘brain circulation’ (DeVoretz, 2006).

Rising reverse immigration levels among the knowledge diaspora have also helped contribute to brain circulation. Where once the main economic ties between immigrants and their home countries were remittances sent to families left behind, today more and more skilled U.S. immigrants eventually return to their home countries. While a limited amount of reverse immigration has always existed (e.g., Stieglitz’s famous 1907 photograph ‘The Steerage’ which supposedly showed immigrants arriving in New York city, was actually of people, some of whom were turned away by U.S. immigration officials, going from New York to Europe), the pace of voluntary reverse immigration has definitely increased in recent years. Evidence from the ‘America’s New Immigrant Entrepreneurs Survey’ by the
Kauffman Foundation (2009), a survey of employment based high-skilled individuals in the United States, indicated that approximately one-in-five new legal immigrants and about one-in-three employment principals either plan to leave the United States or are uncertain about remaining. Those who remain in the United States often become part of transnational communities that link the United States to the economies of distant regions. These new immigrant entrepreneurs thus foster economic development directly, by creating new jobs and wealth, as well as indirectly, by coordinating the information flows, and providing the linguistic and cultural know-how that promote trade and investment with their home countries (Saxenian, 2002).

**Ease of Movement**

With the general lowering of trade and immigration barriers in many countries, as well as the rise of technology that makes it easily possible to stay connected, individuals in the diaspora are finding it much easier to stay in touch with their families, friends and contacts in both the COO and COR, rather than having to choose one place to settle down to the exclusion of the other. In addition, the rise in FDI to the immigrant’s home country financed by immigrant remittances often requires the periodic presence of these immigrant investors, giving rise to transnational households. For example, a common pattern that was observed among the ethnic Chinese in Canada was of one spouse investing and working in the COO and one spouse in North America. Periodically, the original immigrant to Canada would return to his home country, assuring continuous ‘brain circulation’ (DeVoretz, 2006).

**The Rise of Ethnic Professional Associations**

Local ethnic professional associations, such as the Silicon Valley Chinese Engineers Association, The Indus Entrepreneur (TIE) and the Korean IT Forum, provide contacts and resources for recently arrived immigrants (Saxenian, 2002). Many of the professional Indian and Chinese groups in North America have formed important cross-generational forums. Older engineers and entrepreneurs in both the Chinese and the Indian communities now help finance and mentor younger co-ethnic entrepreneurs. According to Saxenian (2006), 53% of the science and engineering workforce in the Silicon Valley is foreign born and one-quarter of immigrant-founded
engineering and scientific companies in the United States during the past
decade were created by Indians. These companies had $52 billion in sales and
created 450,000 jobs. Because of the close ties and sourcing links that these
immigrant-owned companies often have with their COOs, the impact that
ethnic professional associations have in successfully mentoring and nurturing
their owners and managers directly affects international trade and FDI
between the COO and COR.

Emerging ‘War for Talent’

The rise of ‘brain circulation’ signals the need for a new type of business
executive, one that is both technologically proficient and culturally savvy.
This becomes especially important in the case of companies from emerging
economies, such as India and China, who often face a dilemma in attracting
qualified talent. For example, growing affluence at home has enabled a large
number of their people to pursue advanced education abroad. Upon
graduation in disciplines that are in high demand, many of these students
are lured to remain in their adoptive countries through higher salaries and
living standards. At the same time, fast-growing firms from their home
countries are also eager for them to return and work for their expanding
operations, both at home and overseas (Tung, 2007).

This situation has created an unprecedented demand in developing
countries for people who possess cross-cultural management skills. This
lack of trained people can come about through not having the appropriately
trained people, or a situation where these people opt not to work for
companies from developing economies. The latter situation can arise because
of the perception that there are not enough career opportunities in
developing company multinationals, because of geographic distance, cultural
distance, or because of the lower quality of life in developing countries.

A short-term solution to this problem is to recruit managers in the host
countries. These would typically be host country nationals or those from the
home country’s diaspora. It might also be possible to fill this gap by using
nationals of a third country, provided they are trained in the technical fields
and have the cross-cultural skills necessary for international operations
(e.g., Indians in Dubai). However, given the fact that members of the home
country diaspora are more likely to be bicultural and well versed in the
culture of the host economy, their recruitment could give companies from
emerging economies a competitive advantage in the crucial battle for
managerial talent (Chand, 2008).
COO Efforts to Engage the Diaspora

There is an increasing effort on the part of policy makers and firms in a number of emerging economies to leverage their knowledge diasporas for the benefit of the COO. Many have noted the success of the Chinese government in maintaining and expanding contacts with its diaspora, and utilizing them to drive inward FDI. The Chinese government, through successive regimes, has long encouraged the continued engagement of overseas Chinese. With the reform and the economic opening that began in the late 1970s, commercial investment by Chinese communities overseas has been even more strongly encouraged. As early as 1942, the Chinese communist party under Chairman Mao had established an ‘Overseas Affairs Committee’ to encourage engagement with the Chinese abroad. After the founding of the People’s Republic in 1949, China quickly set up an official organization named the Overseas Chinese Affairs office in the central government to formulate policies on, and develop policies with, overseas Chinese. It held the same official status as the Foreign Affairs Ministry (Yin, 2005).

On the other hand, the Indian government’s policies have not been, until very recently, very supportive of, or encouraging toward, FDI from India’s overseas communities. India’s first Prime Minister Jawaharlal Nehru urged overseas Indians to identify themselves with and integrate in the mainstream of the social and political life of their country of domicile. This approach may have been perceived as one of indifference towards the concerns of the diaspora, but it was grounded in the principle that regardless of the origins of a country’s citizens, loyalties should lie within the country of domicile and not outside, something that was particularly germane to the post-partition India Nehru was leading. India’s policy during the cold war was based on neutrality, and solidarity with the ‘Third World’, in which friendship with newly liberated African and Asian countries was highly valued. Until the mid-1990s, the government of India took a ‘hands-off’ policy toward its diaspora; it did not want to appear to be interfering in the domestic affairs of other, especially newly independent, countries with large diaspora populations (Kudaisya, 2006).

In recent years, noting the impact that the Chinese diaspora had on the Chinese economy, the Indian government has made a concerted attempt to leverage its diaspora. In September 2000, the Government of India set up a high-level committee under Dr. Singhvi, an eminent jurist, former member of parliament and India’s longest serving envoy to the United Kingdom, with the mandate to make a comprehensive study of the global Indian diaspora and recommend measures for building constructive relationships.
with it (Kapoor et al., 2004). In response to the committee’s recommendations, in January 2003, the Indian government organized the first global meeting of the non-resident Indians (NRIs), which attracted over 2,000 diaspora Indians from 63 countries. It was the largest gathering of overseas Indians in the country’s history. This first global NRI meeting included Nobel laureates, writers and business moguls among others. In 2005, dual citizenship was extended to all overseas Indians who had migrated after 1950, and India also started its separate ministry of Overseas Indian Affairs.

**ROLES PLAYED BY MODERN DIASPORAS**

So far, we have looked at the issues that have led to the rising importance of diasporas. However, an important question that needs further examination is what it is that diasporas do that makes them so important for both the COO and the COR. In this section, we take a look at some of the roles that modern diasporas play, and the reasons that make them so uniquely suited to these roles.

*Institutional and Human Capital Development in the COO*

One of the most important roles that modern diasporas have played is in the development of human capital and institutional frameworks in their COOs. The countries that suffered the most from the post-war ‘brain drain’ – Taiwan, Israel, China and India – are also the same that have benefited the most from ‘brain circulation’. Developing countries that invested the most in high-quality higher education were the most likely to lose their most promising young people to developed countries (starting typically with higher education abroad). These countries initially also lacked the modern industrial base to employ the large numbers of graduates who did not leave the country. However, in recent years, U.S. and European educated professionals have started to return to their home countries. By returning home, these ‘New Argonauts’ have created economic and professional opportunities for former classmates and subsequent generations of technical graduates (Saxenian, 2006). This typically involves attempting to transfer venture finance capital, merit-based advancement and corporate transparency to economies with traditions of elite privilege, government control and widespread corruption. For example, in India, early entrepreneurs relied on private telecommunications facilities and power supplies rather than on the
country’s state-run infrastructure, and tried to create more egalitarian organizational structures within their new enterprises. In China, they were critical in opening the door to greater foreign investment.

Providing Transnational Networks

The diaspora also provides vital contacts and networks in the COR that COO entrepreneurs can use to help set up and expand their own international businesses. For example, in a survey of 208 software entrepreneurs in India, 58% indicated that they had lived outside of India as NRIs and 88% stated that they had used the diaspora network to obtain contacts in the United States to help them secure contracts for their start-up firms (Khanna, 2007). Local ethnic professional associations like the Silicon Valley Chinese Engineers Association, TIE and the Korean IT Forum also provide contacts and resources for recently arrived immigrants that help set up cross-national businesses that can take advantage of these transnational networks, thus often benefitting both the COO and COR (Saxenian, 2002). Because of their partly homophilous nature, ties between the diaspora and the COO are easier to form and typically engender greater trust that is vital in overcoming the institutional voids that are seen in most emerging economies.

Drivers of Trade and Investment

Immigrants’ social networks in their COO are also very useful in promoting trade and investment ties between their COO and COR. For example, Saxenian (2002) found that for every 1% increase in the number of first-generation immigrants from a given country, California’s exports to that country go up nearly 0.5%. Diasporas have also been key investors in their COOs. Investment from Overseas Chinese has been the major source of China’s FDI inflows (Buckley, Wang, & Clegg, 2007; Buckley & Meng, 2005). Between 1980 and 2004, China attracted over $336 billion in FDI, with over half that amount estimated to have come from the overseas Chinese. During the same period, India managed to attract only $18 billion in FDI, with only 10% estimated as having come from the Indian diaspora (Geithner, Johnson, & Chen, 2005). Between 2004 and 2007, however, India improved its attraction of FDI considerably, with total FDI in India rising to $73 billion by 2007 (UNCTAD WIR, 2008).
In contrast to the FDI, remittances from the diaspora in India tend to be higher than their Chinese counterparts. In 2000, home remittances from the Indian diaspora reached $12 billion, nearly 8 times the amount remitted by the Chinese diaspora to China. By 2007, India had become the world’s top receiver of remittances, with inflows totalling $27 billion (World Bank, 2008); a spectacular growth from approximately $2 billion in 1990. The World Bank (2008) estimated that the remittances into China were about $25.7 billion in 2007. The differences in FDI and remittances could be a direct effect of the contrasting policies of the two governments toward their diasporas. A more engaged policy toward the diaspora, such as the one displayed by the Chinese government, could have the effect of promoting more long-term investments into the COO, while remittances, which tend to be lower involvement behaviors linking individuals rather than firms, could be relatively unaffected or actually lowered as more funds are used for FDI instead.

Studies have maintained that ethnic ties are crucial elements for doing business and investing in China (e.g., Dixon & Newman, 1998; Luo, 2001; Wong, 1999). According to Zhang (2005), the impact of the overseas Chinese on China’s FDI inflows can be seen at least in two ways. First, the overseas Chinese invest in China based on language and historical bonds; accordingly they possess advantages in operations in China. Second, the overseas Chinese act as a bridge through which foreign investors understand the Chinese culture.

Improving the Nation Brand

In light of the fact that every nation typically evokes a certain cognitive, emotional and normative response from people, every nation can be treated as if they were a brand, at least metaphorically. The nation brand could have been developed deliberately or by default from a myriad of different sources, such as word of mouth, education, mass media, travel, product purchases and dealings with its people (Loo & Davies, 2006). Although they may not be an accurate reflection of the objective reality of the nation, they are nonetheless pervasive and powerful in terms of eliciting responses among others (Papadopoulos & Heslop, 2002). National images can influence many decisions, from consumer purchase, to industrial buying, to FDI in target markets (Loo & Davies, 2006). However, it should be noted that the importance of the nation brand is not uniformly accepted by all management scholars. For example, Buckley, Devinney, & Louviere (2007) in their
structured experimentation-based study demonstrate that managers’ choices of actual investment decisions appear less aligned to traditional models.

Diasporas play an important role in changing attitudes toward their COO and improving the nation brand. Firstly, as they are ethnically affiliated to it and often have important social ties there, they tend to have a more favorable attitude toward their home country. Secondly, as they gradually integrate into the larger society and gain more influence, they might actually be able to drive attitudes toward their COO in a more favorable direction in the society as a whole. Finally, as a part of a group that has ties to both the home and host country, they could help overcome the inherent bias in developed countries against products from developing countries, thus helping overcome the ‘COO effect’.

Immigrant Effect

The immigrant effect refers to the impact that an employer who has immigrants in key decision-making positions has on the success of an international business operation, principally where that firm is engaged in operations in the immigrant’s COO (Hyde & Chung, 2002). Immigrant employees’ knowledge about their COO market is manifested in the areas of culture, language, the legal system, market information and business operations (Chung, 2002; Gould, 1994; Wagner, Head, & Ries, 2002).

The immigrant effect has also been found to be significantly related to bilateral trade flows between the immigrants’ resident countries and their COO (Gould, 1994). For instance, Wagner et al. (2002) found that new immigrants have assisted Canada to significantly expand its bilateral trade flows with the immigrants’ native countries. Similarly, Rauch and Trindade (2002) concluded that ethnic Chinese networks have a significant impact on the bilateral trade among the countries they have examined. Duncan, Bollard, and Yeabsley (1997) investigated interaction between migration, investment and trade, and concluded that immigrants often brought with them important skills, knowledge and networks, providing a foundation for bilateral trade and investment between resident and source countries. These studies point to the important role that immigrants can play in driving bilateral trade and investment between the COO and COR.

Contributing to ‘Soft Power’

Joseph Nye coined the phrase ‘soft power’ in his 1990 book, Bound to Lead. Soft power is the ability to attract and persuade rather than coerce
Nye, 2004). In the national context it stems from the attractiveness of a nation’s culture, ideals and policies; in contrast, hard power grows out of a nation’s military or economic might. India’s first post-independence Prime Minister Jawaharlal Nehru and China’s paramount leader from the late 1970s to the early 1990s, Deng Xiaoping, had both at different times emphasized the importance of not engaging in great power politics, thus clearly if indirectly stressing the importance of soft power for their respective countries.

One of the most significant effects that the Indian and Chinese diasporas have had is their positive impact on the image of products and services from their respective COOs, thus driving the COO effect in a positive direction. This is an area where the Indian diaspora has so far been more successful than its Chinese counterpart. For example, when India’s Titan Watches first entered the international market, it branded its product as ‘the world watch’, partly to disguise its origins. The company knew that many customers just wouldn’t accept a high-end watch made in India. Today, the made-in-India mark is not barring brands from moving up the value chain (IBEF, 2009). Although it is difficult to exactly calculate its total business impact, the surge in Asia’s soft power is based on powerful commercial and geopolitical undercurrents that in some ways reflect the rising importance of the region to the global economy.

A LOOK TO THE FUTURE: EMERGING ISSUES FOR DIASPORAS

The roles of diasporas are undergoing a change as the pressures of globalization on the one hand and the pull of the homeland on the other presents them with a unique set of challenges. While their respective COOs try to leverage them as assets, sometimes, there is also pressure to become a part of the COR, more so in some countries than in others, leading to questions of identity. This becomes more important as generations grow up in the COR and inter-marriages occur. Issues of intra-country regionalism remain as well – simply being in a different country has not always been a reason to overcome intra-national differences. All of this is occurring in the backdrop of rapid economic growth in a number of emerging economies, including the two largest that we have closely looked at, China and India. As these countries continue to grow, some of the economic reasons to migrate might be growing less important, and indeed, may in fact be leading
to a limited diaspora migration (or remigration) to the COO. We now examine some of these emerging issues in greater detail.

A Question of Identity

The self-identity of diasporas as to how they see themselves and how they manage the two distinct cultures of their COO and COR is one of the most important issues that could shape their future behavior. The biculturalism in members of the diaspora can be associated with feelings of pride, uniqueness, a rich sense of community and history, while also bringing to mind identity confusion, dual expectations and value clashes (Haritatos & Benet-Martínez, 2002). Furthermore, biculturals often report dealing with the implications of multiple racial stereotypes and pressures from different communities over their loyalty and behavior (La Fromboise, Coleman, & Gerton, 1993). An important issue, then, is how individuals who have internalized more than one culture negotiate their different, and often opposing, cultural orientations, as well as the role that external and internal factors play in this process. A useful tool in helping explain the complex issue of identity is the bicultural identity integration scale or BII, developed by Benet-Martínez and Haritatos (2005). BII, which was drawn from an extensive review of the empirical and qualitative acculturation and biculturalism literature, captures the degree to which ‘biculturals perceive their mainstream and ethnic cultural identities as compatible and integrated vs. oppositional and difficult to integrate’ (Benet-Martínez, Leu, Lee, & Morris, 2002, p. 496). Individuals high on BII tend to see themselves as part of a ‘hyphenated culture’ (or even part of a combined, ‘third’ emerging culture) and find it easy to integrate both cultures in their everyday lives. Biculturals low on BII, on the other hand, report difficulty in incorporating both cultures into a cohesive sense of identity (Phinney & Devich-Navarro, 1997). Although low BII biculturals also identify with both cultures, they are particularly sensitive to specific tensions between the two cultural orientations and see this incompatibility as a source of internal conflict. BII involves two independent psychological constructs, cultural conflict and cultural distance, each representing unique and separate aspects of the dynamic intersection between mainstream and ethnic cultural identities in bicultural individuals (Benet-Martínez & Haritatos, 2005). Cultural conflict is based on the perception that mainstream and ethnic cultures clash with one another. Cultural distance refers to the perception that one’s two cultures are non-overlapping, dissociated and distant from one another.
The bicultural identity of diaspora individuals can also impact their ability to facilitate trade and investment between their COO and COR. For example, in his study on the role of the Indian diaspora in facilitating bilateral trade between United States and Canada, on the one hand, and India, on the other, Chand (2009a) found that individuals high on cultural distance were more likely to have investments in their COO. However, cultural conflict had no direct impact on FDI behavior. An important point to consider for the future is how a diaspora’s self-identity could change over time and how this could impact its ability to drive trade and investment between the COO and COR. For example, could the Chinese diaspora’s becoming more ‘Americanized’ over generations be causing it to become more detached from the COO and thus less able and willing to drive investments to China?

**COR Acculturation Policies**

Immigrant groups are not always free to choose how to acculturate (Berry, 1974), as their experience depends to a large extent on the conditions in the larger COR community. The dominant community can have a number of different possible attitudes toward the acculturation that can take place. The acceptance of cultural diversity and integration by the larger society defines the attitude of mutual accommodation known as multiculturalism (Berry, 1984). When assimilation is the preferred outcome by the dominant community, it is termed the melting pot. When separation is enforced by the dominant group, it is termed segregation. When marginalization is imposed by the dominant group, it is a form of exclusion (Bourhis, Moise, Perreault, & Senecal, 1997). The United States and France are examples of countries that pursue melting pot policies, while Canada and Australia are examples of countries that practice multiculturalism.

The COR acculturation policy can have an important effect on the diaspora’s feeling of being at ‘home’ and in its motivations toward the COO and COR. Findings from Chand (2009b) indicate that the Indian diaspora in Canada, after controlling for time spent in the COR and income and education levels, is less likely to invest in the COO than its counterpart in the United States. Although there could be a number of possible explanations for this, one hypothesis is that multiculturalism is more likely to foster feelings of being at ‘home’ in the COR, and thus less likely to create the incentive of investing in the ‘home’ country.
Intra-Country Regionalism

Aside from the strong affinity to their COO as a whole, regionalism also has an overriding influence on the diaspora’s choice of the exact location for their investment. This strong regionalism serves to account for the fact that the bulk of Taiwanese investment in China is in Fujian province in southeastern China, the ancestral home of many of the present-day Chinese inhabitants in Taiwan. The same is true for Hong Kong Chinese whose preferred investment destination is Guangdong province in southern China (Tung, 2008). In India, where there are marked religious and language differences across regions, this regionalism is perhaps even stronger than that in China; Tung and Chand (2007) found that most of the investments from Indo-Americans or Indo-Canadians into India are bound for their home states. An important question to consider is whether being in the diaspora actually enhances regional identities, and if so, whether these are in addition to or in place of national identities.

Rising Living Standards in Emerging Economies

As economic growth in emerging economies continues to outpace that of industrialized economies, and as living standards there continue to rise, it is likely that a major driving force for emigration might be becoming less powerful, especially for members of the knowledge diaspora. In fact, as overseas Chinese and Indians ponder the option of returning to their respective COOs, the Chinese and Indian governments have been busy sending strong welcome messages to lure them home. With the rise of reverse immigration, we might be seeing the beginnings of a ‘war for talent’ between the industrialized and emerging economies. The people most likely to return are those who typically are the most educated and have well-developed social networks, and can take advantage of the offers of their COO governments. However, since they often have dual nationalities, their COOs stand the chance of losing them again should growth slow down in these countries. Thus, neither immigration nor reverse immigration need to be permanent any more – we might see an even more fluid ‘brain circulation’ in the future.

CONCLUSION

This paper has examined the importance of diasporas as drivers of national competitiveness. It has used the interrelationship between the diverse
concepts of brain circulation, transnational social networks, immigrant
effect, COO engagement policies and soft power to explain how diasporas
can help increase the competitiveness of nations. It has looked at how
emerging issues such as diaspora identity, intra-country regionalism, COR
acculturation policies, and rising COO growth levels could affect the
complex relationship between the diaspora and its COO and COR.

While diasporas have existed for thousands of years, globalization and
increasing human and capital mobility have increased their importance and
left them uniquely positioned to act as drivers of trade and investment
between their COO and COR. The leveraging of the advantages provided by
the knowledge diaspora have been especially important in the case of
the emerging economies such as China and India, which have benefited
greatly from the contribution of the members of their ethnic diasporas.
However, all of this is occurring on a backdrop of changing conditions
in both the COO and COR, as well as a changing balance of power in the
global economy, presenting diasporas with a unique set of challenges and
opportunities in the near future.

One of the main challenges for decision makers in emerging economies is
enticing members of the knowledge diaspora to return on either a temporary
or permanent basis. For industrialized economies, while they are currently
benefitting from high-tech immigrants, the question is whether they can
count on being on the winning side of this ‘war for talent’ indefinitely. If the
situation does change, such as through the rise of reverse immigration of the
knowledge diaspora, do they have contingency plans that could maintain
their advantage? This question becomes especially important with the
comparatively higher economic growth rates and rising living standards in
emerging economies.

In terms of theoretical implications, the concepts introduced in this paper
suggest that what constitutes home versus host country for immigrants is no
longer as clear-cut as it used to be. This has major implications for cross-
cultural research – for example, in a study of work values, should diaspora
individuals be considered as a member of the host country or home country,
or do they fall into a separate category completely? How would their
biculural identity impact their effectiveness in driving transnational
networks? In light of brain circulation, can we really talk about a ‘brain
drain’ or ‘brain gain’ anymore? Another important theoretical implication is
the idea that ‘brain circulation’, because of its inherent use of social
networks, is an important driver of trade and investment ties between
the COO and COR. This could also help address the gap that Filatochev,
Liu, Buck, and Wright (2009) referred to in terms of research on how social
capital and global networks of returning entrepreneurs may affect the internationalization of firms. For similar reasons, brain circulation also fuels the immigrant effect and potentially the reverse immigrant effect. COR differences in acculturation policy can impact the feelings of being at ‘home’ in the COR, and thus potentially the propensity for brain circulation and trade facilitation to the COO.

Studies on FDI to COO need to further incorporate the effect of intra-country regionalism that drives investment to particular regions, and investigate whether regional identity exists in addition to, or in conflict with, national identity. IB theorists also need to include the concept of ‘soft power’, which so far has been almost completely ignored in the literature, in their explanations of the roles that diasporas can play in enhancing the national competitiveness of both the COO and the COR. Soft power is also indirectly helpful in building up the nation brand, and moving the COO effect in a positive direction.

As the increasing set of interrelationships between these diverse concepts becomes clearer, their role in driving the relationship between the diaspora and their COO and COR becomes more important. Thus, some of these paradigms may have to be revisited and revised to take into consideration these new realities. These changes could help redefine the role of diasporas, and nations that are the most effective at understanding and leveraging these could greatly magnify their national competitiveness as the global economy continues to integrate and the war for talent intensifies.

REFERENCES


INTERNATIONALIZATION OF EMERGING MARKET FIRMS: A CASE FOR THEORETICAL EXTENSION

Ajai Gaur and Vikas Kumar*

ABSTRACT

Research on internationalization of emerging market firms (EMFs) has received an increasing attention in the international management field. A central argument in a majority of these studies is that the internationalization of EMFs is different from that of firms from developed economies, and existing internationalization theories are insufficient to fully explain this new phenomenon. We conduct a critical review of important studies on the internationalization of EMFs to address two related questions. First, is the internationalization of EMFs really a new phenomenon, never been witnessed in the past? Second, does it warrant new theoretical developments? Our review suggests that there are important variations in the internationalization strategies of EMFs and developed economy firms, within EMFs from different emerging economies, and during different time periods. A thorough understanding

*The two authors contributed equally.
of motivations, paths, processes, and performances of EMFs does require new theoretical approaches that can take into account the unique aspects of EMFs.

INTRODUCTION

The international activity of emerging market firms (EMFs) has undergone phenomenal growth in the past few years (Guillen & Garcia-Canal, 2009; Ramamurti & Singh, 2009). From a meager amount in the early 1980s, when EMFs accounted for 6 percent of global FDI outflow totaling USD 52 billion, there has been a phenomenal growth, with EMFs accounting for 15 percent of the USD two trillion global FDI outflow in 2007 (Almeida, Lu, Rangnekar, & Schizer, 2010). Emerging market exports already account for some 45 percent of the world’s total FDI outflow (The Economist, 2006). This growth has generated strong interest among scholars and practitioners in understanding EMF internationalization. However, EMF internationalization is not a recent phenomenon as the roots of research on this topic go back by over 30 years (Lecraw, 1977; Wells, 1983).

A major thesis advanced in literature is that the internationalization of EMFs is different from that of firms from developed economies. This has become an important point of debate and discussion in academic literature (Luo & Tung, 2007; Mathews, 2006; Peng & Delios, 2006). For example, prior to 2000, the principal recipients of this international expansion by EMFs had been mostly other emerging economies, typically in the same geographical region or cultural domain; a trend in line with the Johanson and Vahlne (1977) paradigm of incremental internationalization. Since the turn of the century, however, substantial FDI from emerging markets is now targeted toward developed OECD markets, much of it through aggressive internationalization mechanisms such as cross-border mergers and acquisitions, rather than the less-risky and more typical modes used in the past by EMFs, such as joint ventures or green-field subsidiaries (OECD, 2005). This more aggressive push abroad is motivated by a desire to tap resources, skills, markets, and brand names and increase global competitiveness (Gaur, Kumar, & Singh, 2009).

A common rationale advanced to justify new research on EMF internationalization is that the contextual differences between developed and emerging economies are substantial, which implies the need for a new theoretical lens with which to assess the internationalization of EMFs,
as existing internationalization theories are insufficient to fully explain this new phenomenon. In this paper, we conduct a review of important studies on the internationalization of EMFs published in the past 30 years to address two related questions. First, is the internationalization of EMFs really a new phenomenon; one never witnessed in the past? Second, does the internationalization of EMFs warrant new theoretical developments?

Our review details the limitations faced by corporations expanding out of an emerging market home base and identifies the advantages that are also supposed to accrue to firms from their emerging market base. The review identifies how the drivers and motives for internationalization differ between the EMFs and firms based in developed economies. We also identify how EMFs are affected by different cultural underpinnings, marketing experience, organizational forms, resource endowments, locational advantages, regulatory environment, modes of entry into foreign markets, degree of internationalization (incremental vs. born-global), entrepreneurial history, network or ethnic ties, or capital availability; and how this background has led EMFs to evolve distinct strategies for their international expansion. We raise the important issue of applicability or nonapplicability of the current theories of international expansion to EMFs. Such an analysis is likely to have important implications for theory building as well as for firms’ global business strategies in the future. Finally, we discuss the limits of our current knowledge and set an agenda for further research.

**EMERGING MARKET FIRM INTERNATIONALIZATION**

The topic of EMF internationalization has witnessed increased scholarly attention. Recent special issues in important international business and management journals have been dedicated to research on or related to the internationalization of EMFs (*Journal of International Business Studies*, 2007, 2010; *Management International Review*, 2009; *Journal of Management Studies*, 2005; *Journal of International Management*, 2007; *Corporate Governance: An International Review*, 2009; *Industrial and Corporate Change*, 2009). In addition, various edited books on the topic such as those by Goldstein (2007) and Ramamurti and Singh (2009) have gained prominence in the international management community.

This growing body of literature on EMF internationalization has not only improved our understanding of the internationalization process of EMFs,
but has more importantly contributed immensely to the broader international business theories. For example, the role of networks, something identified by scholars as a unique and distinguishing aspect of EMF internationalization, has been given far greater importance in an update by Johanson and Vahlne (2009) on their incremental internationalization theory first propagated in 1977. Similarly, Dunning (2006) acknowledged the limitations of his ownership–location–internalization (OLI) paradigm in the context of EMF internationalization. OLI, as conceptualized in its early years (late 1970s and early 1980s), has explained the internationalization of western multinational enterprises (MNEs) well, but may be constrained in effectively explaining EMF internationalization. The linkage–leverage–learning (LLL) model (Mathews, 2006) developed to overcome the shortcomings of the OLI framework has elements that are better equipped in explaining not only the accelerated or rapid internationalization witnessed in the context of EMFs, but also the born-global phenomenon.

In the following sections, we review some of the important studies on EMF internationalization, teasing out the motivations, paths, processes, and performances, as explicated over the past 30 years, and comment on how they differ on these vis-à-vis western MNEs. Table 1 presents a summary of some of the more recent work on internationalization of EMFs. At this stage, we would like to clarify that our paper in no way presents an exhaustive review of all the important work on EMFs, rather it is an attempt to understand the important issues in the internationalization of EMFs through the analysis of a few studies.

**Motivations**

In this section, we discuss some of the motivations for firms to internationalize their operations and how the motives differ for EMFs from those for developed market firms. The internationalization of firms based in emerging markets springs from multiple motives. These range from overcoming small scale in the home market (i.e., acquiring globally competitive scale), to accessing raw materials or knowledge (Deng, 2004), to FDI intended to overcome export barriers. Entry into developed nation markets or high-technology milieus is sometimes an attempt to acquire the legitimacy a firm lacks, or to overcome the negative country-of-origin label as seen by consumers in developed economies (Deeds, Mang, & Frandsen, 2004). Some firms are motivated by a desire to escape from stifling regulatory constraints at home (e.g., SabMiller’s globalization motive to escape its South African...
Table 1. Summary of Recent Studies on EMF Internationalization.

<table>
<thead>
<tr>
<th>Author(s)</th>
<th>Theme</th>
<th>Setting</th>
<th>Key Arguments/Findings</th>
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<tbody>
<tr>
<td>Aulakh (2007)</td>
<td>Motives, paths, and performances</td>
<td>Theoretical</td>
<td>EMFs use both existing ownership advantages and acquire resources and capabilities from others in their internationalization process.</td>
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<tr>
<td>Bonaglia et al. (2007)</td>
<td>Paths and processes</td>
<td>Three firms – Haier (China), Mabe, (Mexico), and Arcelik (Turkey)</td>
<td>Success of these firms lies in their ability to treat global competition as an opportunity to build capabilities, move into more profitable industry segments, and adopt strategies that turn latecomer status into a source of competitive advantage.</td>
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<tr>
<td>Chen and Chen (1998)</td>
<td>Motives and paths</td>
<td>554 Taiwanese firms (1994)</td>
<td>Network linkage is an important determinant of location choice in FDI.</td>
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<td>Child and Rodriguez (2005)</td>
<td>Motives and processes</td>
<td>Case Studies of Chinese Firms</td>
<td>Chinese firms are seeking technology and brands to address their competitive disadvantage. They engage in inward internationalization through original equipment manufacturer (OEM) and outward internationalization through acquisition and organic expansion.</td>
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<td>Author(s)</td>
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<td>Cuervo-Cazurra and Genc (2008)</td>
<td>Motives and paths</td>
<td>FDI in 49 LDCs (1999 and 2001)</td>
<td>Developing-country MNEs, even though rarely appear among the largest MNEs in the world, they are more prevalent among the largest foreign firms in the least developed countries (LDCs), with poorer regulatory quality and lower control of corruption.</td>
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<tr>
<td>Filatotchev et al. (2009)</td>
<td>Process and performance</td>
<td>711 SMEs in China</td>
<td>Export orientation and performance depend not only on the development of capabilities through R&amp;D and technology transfer, but also on the founder’s international background, global networks, and the presence of a “returnee” entrepreneur.</td>
</tr>
<tr>
<td>Luo and Tung (2007)</td>
<td>Motives, paths, and processes</td>
<td>Theoretical paper</td>
<td>Springboard perspective: EMFs use international expansion as a springboard to acquire strategic resources and reduce their institutional and market constraints at home.</td>
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<td>Morck et al. (2008)</td>
<td>Motives, paths, and processes</td>
<td>Aggregate Chinese FDI (2003–2006)</td>
<td>China’s outward FDI is biased towards tax havens and Southeast Asian countries and are mostly conducted by state-controlled enterprises with government sanctioned monopoly status.</td>
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<td>Mathews and Zander (2007)</td>
<td>Motives, paths, and processes</td>
<td>Theoretical paper</td>
<td>The internationalization of newly internationalizing firms can be understood by integrating elements of entrepreneurial and internationalization perspectives.</td>
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<td>Author(s)</td>
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<td>Key Findings</td>
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<tr>
<td>Miller et al. (2008)</td>
<td>Performance</td>
<td>EMF banks can use ethnic identity as a resource to achieve competitive parity in developed markets.</td>
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<td>Nayyar (2008)</td>
<td>Motives</td>
<td>Liberalization of policy regime and greater access to financial markets were primary factors driving increased Indian FDI.</td>
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<td>Pradhan (2004)</td>
<td>Motives/determinants</td>
<td>Age, size, R&amp;D intensity, skill intensity, and export orientation are important determinants of Indian outward FDI.</td>
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<td>Rui and Yip, 2008</td>
<td>Motives, paths, and processes</td>
<td>Case study of three Chinese firms Chinese firms use cross-border acquisitions to achieve goals, such as acquiring strategic capabilities to offset their competitive disadvantages and leverage their unique ownership advantages, while making use of institutional incentives and minimizing institutional constraints.</td>
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<td>Sol and Kogan (2007)</td>
<td>Processes</td>
<td>Know-how of business strategy during economic liberalization was a source of competitive advantage for Chilean firms operating in Latin America.</td>
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<td>Thomas et al. (2007)</td>
<td>Processes and performance</td>
<td>Developed market experience positively affects entry and survival of EMFs in developed markets.</td>
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<tr>
<td>Yiu et al. (2007)</td>
<td>Motives and processes</td>
<td>Relationship between firm-specific ownership advantages and international venturing is moderated by the degree of home industry competition and export intensity. In addition, this relationship is mediated by the intensity of corporate entrepreneurial transformation in the form of innovation, new business creation, and strategic renewal.</td>
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context, cited in Luo & Tung, 2007), or simply by a misalignment between firm capabilities and the home institutional environment (Witt & Lewin, 2007).

Risk diversification, exploiting experience with labor-intensive technology, social network through ethnic ties, small home markets, and acquisition of management expertise in marketing, technology, and general management are some of the key motivating factors in the internationalization of EMFs. On the other hand, threats to existing markets, exploiting experience with high-technology production, and exporting back to developed home markets stand out as some of the key motivating factors in developed market firms’ internationalization (Lecraw, 1977, 1993). An interesting difference in FDI motivation, as noted in the study of Korean construction companies investing in foreign locations, primarily in the middle-eastern countries, was the use of domestic Korean manpower for operations in foreign locations (Ghymn, 1980). Using domestic human resources abundantly in foreign locations as a motivation for FDI and as an international strategy is quite different from that of developed market MNEs, for whom reducing production costs through low wage workers has been one of the major attractions of investing abroad. Indian software firms, in a similar vein, have successfully utilized such an internationalization strategy of exporting their software professionals to foreign affiliates (Kapur & Ramamurti, 2001).

Another notable difference with regards to FDI motivation for EMFs pertains to motivations arising out of home and host country institutional environments. As noted earlier, many EMFs engage in outward FDI in order to escape from stifling regulatory constraints at home (e.g., SabMiller’s globalization motive) or to overcome negative country-of-origin effects and acquire legitimacy in international markets (Deeds et al., 2004). For others, a weak institutional environment (in the host country) characterized by political instability acts as a motivation to invest and benefit from being first movers in other institutionally unattractive locations. Buckley et al. (2007) show that Chinese FDI is attracted, rather than deterred, by political risk. Del Sol and Kogan (2007) demonstrate that affiliates of Chilean firms successfully operated in Latin American countries (emerging markets), in spite of domestic institutions being relatively weak and the economy going through a period of liberalization. Their experiences of conducting business at home during a period of economic liberalization acted as a source of unique competitive advantage vis-à-vis other local firms. Cuervo-Cazurra and Genc (2008) argue that emerging market MNEs are at a competitive advantage compared to developed market MNEs when entering and operating in other emerging markets, since their experiences of operating
in their home countries – usually characterized by underdeveloped institutions and difficult governance conditions – act as a valuable and inimitable capability. Thus, instead of acting as a deterrent, harsher institutional environments sometimes act as a motivating factor in EMF internationalization. This is a significant shift in terms of internationalization motivations from the known experiences of developed market MNEs.

A changing trend of FDI from emerging markets is that an increasing amount of this FDI is directed toward developed markets. Some of the motives for this are unique to the case of EMFs. Yamakawa, Peng, and Deeds (2008), in their study on emerging market new venture firms entering developed markets, proposed an exhaustive set of motivating factors: a high degree of domestic industry competition, a high degree of industry technology intensiveness, organizational motives to access new capabilities, involvement of new venture capitalists from developed markets, strategic alliances with developed market firms, high level of entrepreneurial orientation, a discriminating domestic regulative environment against new ventures, potential to enhance legitimacy at home and abroad, and managerial cognitive value association with international expansion to developed markets were argued to be significant motivations for EM new ventures to enter into developed markets. Thomas, Eden, Hitt, and Miller (2007) in their study on internationalization of Latin American firms found that alliance experience with developed market firms, along with an entrepreneurial mindset of going abroad were critical motivating factors for entry and survival of these firms in developed markets. Miller, Thomas, Eden, and Hitt (2008), found prevalence of ethnically similar customers as well as competitors to be a source of motivation for EMFs to internationalize into developed markets. Miller et al. (2008) argue that EMFs can use similar ethnic communities in developed markets as a basis to develop rare and inimitable resources, giving them an edge over local developed market firms. Kapur and Ramamurti (2001) discussed the important role played by the large Indian diaspora communities in developed markets in the successful internationalization of Indian software firms (see, e.g., Chand in this volume). Such relational factors acting as major sources of motivation for firms to invest abroad were not as significant or as prominently discussed in the context of developed market firms.

**Paths**

In this section, we discuss the changing internationalization paths of EMFs and how they differ from those of developed market firms. Historically,
almost all FDI emanating from emerging markets was targeted toward other emerging markets (Wells, 1977). A number of studies on EMF internationalization reveal that EMFs tend to invest in geographically proximate countries. Several scholars have shown that firms from emerging markets such as Taiwan (Chen, 2003), Singapore (Pang & Komaran, 1985), and South Korea (Tallman & Shenkar, 1994) limit their internationalization to other Asian countries which are geographically close and at similar or less advanced stages of development compared to their home countries. Morck, Yeung, and Zhao (2008) show that outward FDI from China, the largest foreign direct investor among the emerging markets, is geographically biased to other emerging markets. Using statistics from the Chinese Ministry of Commerce, they show that Asia, Latin America, and Africa accounted for 63.9, 26.3, and 3.4 percent of the FDI stock respectively, whereas North America and Europe accounted for very small amounts (less than 3 percent each).

The above text illustrates the unidirectional nature of FDI from emerging markets. Nonetheless, there is growing evidence hinting that the directionality of FDI from emerging markets is changing, particularly given the increased global integration and changing institutional and industrial dynamics in many emerging markets (Narula & Dunning, 2000). Ramamurti and Singh (2009) report that substantial portions of Indian FDI have gone to developed markets since the economic liberalization drive of the early 1990s. Most of the international activity of Indian information technology firms is directed toward developed markets (Gaur & Kumar, 2009). Miller et al. (2008) and Thomas et al. (2007) suggest that developed markets have become an important target location for many EMFs based in Latin America. Buckley, Cross, Tan, Xin, and Voss (2008) report that Chinese FDI was directed very early on to developed markets and to locations that were psychically and geographically distant. Buckley et al. (2007) also suggest that increased amounts of Chinese outward FDI were going to OECD countries (developed markets). Although these reports are contradictory to Morck et al.’s (2008) findings, this is reflective of the changing trend in directionality of FDI emanating from large emerging markets and starts raising interesting questions.

Are such paths of internationalization different from those adopted by developed market MNEs? To the extent that EMF internationalization has been focused and directed toward other emerging markets, there seems to be no distinction between EMFs and developed market MNEs. However, in the short span of time since EMFs have begun to internationalize, at least some of them have aggressively pursued an international strategy focused as much
on developed markets as on emerging markets. This could serve as a distinguishing feature of the internationalization path of EMFs and developed market MNEs.

Processes

In this section, we discuss the typical process of internationalization that is associated with EMFs and how that has dramatically changed in the recent years, resulting in even greater differences between the EMF and developed market firm internationalization process. For most of their international markets forays, EMFs have historically used an export-based strategy (Aulakh, Kotabe, & Teegan, 2000; Child & Rodriguez, 2005; Yiu, Lau, & Bruton, 2007). A number of studies on EMFs have focused on factors influencing this strategy. In the case of Peruvian textile firms, Daniels and Robles (1982) found that adoption of capital-intensive technologies in the production process had a positive impact on their exports as such technologies improved product quality perception and delivery reliability, and lowered production costs for the more competitive foreign markets. Filatotchev, Dyomina, Wright, and Buck (2001), in their examination of privatized firms in Russia, Ukraine, and Belarus, discovered that strategic choices pertaining to external acquisitions, managerial turnover, foreign partner, and product development, as well as governance issues such as managerial and outside control, had a significant impact on these firms’ export intensity. Filatotchev, Liu, Buck, and Wright (2009) show that, in addition to R&D and technology capabilities, entrepreneurial characteristics, such as founder’s international background and global networks, and the presence of a “returnee” entrepreneur, had a positive influence on the export orientation and performance of high-technology EMFs. Dominguez and Sequeira (1992) proposed different types of export strategies (low involvement-low volume-low content, price-cost-volume, and product-service quality oriented) for EMFs based on the level of diversification in their export products and markets.

Export-led growth from emerging markets, like Argentina, Brazil, Hong Kong, India, South Korea, and Taiwan, soon started to be complemented and reinforced by FDI by firms from these countries. Firms made FDI primarily in the manufacturing sectors characterized with high labor intensity and price sensitivity (Wells, 1983). However, some EMFs made FDI outside the manufacturing realm, in a diverse set of sectors such as
trading, warehousing, transportation, mining, forestry, and construction (Ghymn, 1980; Kumar & Kim, 1984). Also, several of these firms were not small-scale producers of standard products as was thought to be the case (Lall, 1983). EMFs that were internationalizing formed a heterogeneous group of firms right from the early days of their internationalization (Dymsza, 1984; Ramamurti, 2009).

A unique feature of some of the EMFs has been their tendency to “jump” from no involvement or simple exports to direct investments in foreign subsidiaries (Lecraw, 1993). This has gained momentum in the recent years and has been described as the phenomenon of “accelerated internationalization,” a feature distinctly associated only with EMFs (Bonaglia, Goldstein, & Mathews, 2007; Luo & Tung, 2007; Mathews, 2002; Mathews, 2006; Mathews & Zander, 2007). Mathews (2006) presents the LLL theory to describe the rapid internationalization that some of the firms from emerging markets have achieved. He argues that the traditional OLI theory (Dunning, 1980) is too constrained in many respects to fully explain the rapid internationalization that is witnessed in the case of emerging market MNEs. One such constraint relates to ownership of traditional resources and advantages accrued in the internationalization process. EMFs do not possess many of the resources necessary to internationalize in the traditional sense. Then, what explains their fast-paced internationalization process? Luo and Tung (2007) present the “springboard perspective” of EMF internationalization, and suggest that EMFs overcome their latecomer disadvantage in the international market place by aggressive acquisitions of assets from mature MNEs. Asset-seeking and asset-augmenting FDI strategies are what emerging market MNEs have pursued in their internationalization process (Makino, Lau, & Yeh, 2002; Mathews, 2002; Mathews, 2006), as compared with the asset-exploiting FDI strategy pursued by developed market MNEs.

Emerging market MNEs, generally considered to be lacking in resources, do possess firm specific advantages but of a very different nature to those possessed by developed market MNEs. Production know-how of emerging market MNEs emerged from their capabilities in small-scale labor-intensive manufacturing, and their marketing know-how emerged from being able to serve specialized niche market segments such as the small expatriate ethnic communities (Wells, 1983). Young, Huang, and McDermtott (1996) in their qualitative study of five Chinese state-owned enterprises highlight the international catch-up process that Chinese firms have undergone and the important role of distinctive technological proprietary assets held by these firms in their internationalization process.
EMFs also develop unique capabilities from their experiences of operating in underdeveloped institutional environments, which they exploit in internationalizing into other emerging markets with similar environments (Wright, Filatotchev, Hoskisson, & Peng, 2005). For example, Del Sol and Kogan (2007) describe how Chilean firms outperformed local firms in Latin America based on their experiences of strategizing in their home country which was undergoing institutional evolution. Other advantages for EMFs emerge from their social and business networking or linkages that they readily use in their internationalization process (Elango & Pattnaik, 2007; Zhou, Wu, & Luo, 2007; Yiu et al., 2007). Chen and Chen (1998) in their study of Taiwanese firms found that network linkages, both intrafirm as well as interfirm, were important determinants of FDI location choice. Furthermore, they found that strategic interfirm linkages motivated Taiwanese FDI in the United States, whereas relational interfirm linkages facilitated their FDI in Southeast Asia and China. Such sources of advantage derived from operating in difficult environments, social networking, and linkages are unique to EE firm internationalization and have been observed to a far lesser extent in developed market firm internationalization.

Performance

Research on performance implications of EMF internationalization suggests that, similar to that for developed market firms, the performance of internationalizing EMFs is, to a large extent, determined by the degree of internationalization the firm has achieved (Nachum, 2004). Given that the average emerging market MNE has achieved a lower degree of internationalization than their developed market counterparts, their internationalization–performance relationship is accordingly reflected only by a U or inverted-U shaped curve (Contractor, Kumar, & Kundu, 2007; Gaur & Kumar, 2009; Thomas, 2006) as compared to the S-shaped curve reflecting this relationship for developed market MNEs (Contractor, Kundu, & Hsu, 2003; Lu & Beamish, 2004). In the case of both emerging market and developed market MNEs, this relationship is influenced by a number of other factors including the resource base (marketing and R&D intensity) and the institutional environment of the home and host country markets (Chao & Kumar, 2010; Gaur & Kumar, 2009; Kotabe, Srinivasan, & Aulakh, 2002; Kumar & Singh, 2008; Venzin, Kumar, & Kleine, 2008).
In this section, we focus on highlighting some of the most conspicuous distinctions in the internationalization strategy of EMFs vis-à-vis their counterparts based in developed markets. In addition to the normal hazards of initiating a new business, international expansion incurs the additional obstacles of “liabilities of foreignness” because of cultural unfamiliarity and imperfect knowledge (Caves, 1971) or lack of legitimacy (Kostova & Zaheer, 1999). From a resource-based perspective, EMFs were (and are) supposed to have weaker technology, capital, marketing, and management (Lall, 1983; Wells, 1983), to operate in home markets with insufficient competition because of a number of government regulatory mechanisms (Kumar & McLeod, 1981), to enjoy a smaller scale, to be younger or recently privatized, and to possess management capabilities and decision-making processes that are not fully developed (Lyles & Baird, 1994). Also, their lack of international experience and recognized brand names will lead to a strong search for legitimacy in the international context and resources in the marketplace (Hitt, Dacin, Levitas, Arregle, & Borza, 2000). Despite progress, emerging markets have weaker institutions, intellectual property protection laws, commercial laws, and relatively inefficient labor and capital markets. Many have opaque or capricious regulations, corruption, and political risk (Luo & Tung, 2007). Corporate governance in some EMFs can be weak, lack disclosure, and be compromised by family or government equity holdings. Managers are often less technically specialized or internationally experienced than their developed market counterparts (Tung, 1994).

However, it is clear that many EMFs have developed organizational and strategic innovations that more than compensate for their lack of technical and managerial capabilities (Mathews, 2006). The harsh environmental conditions at home described above have motivated surviving EMFs to develop unique competencies, some of which prove valuable in foreign markets (Sinha, 2005). The rise of companies such as Ranbaxy Laboratories from India, Samsung from Korea, and Acer from Taiwan, into powerful global giants clearly demonstrates aspects of this. Moreover, the resource configuration of EMFs is more likely to be similar to the resource configuration required to operate successfully in other emerging markets, owing to similar institutional and cultural settings (Wright et al., 2005). When expanding into other emerging markets, which are increasingly becoming highly profitable and high-growth potential markets, EMFs can
exploit their resources in a manner potentially superior to those possessed by developed market firms.

The recent large acquisitions by companies like Lenovo, Mittal, Cemex, or Tata Steel have led some to argue that at least some EMFs have a higher tolerance for risk. Examining Chinese outward direct investment (ODI), Buckley et al. (2007) conclude that “… Chinese ODI is attracted, rather than deterred, by political risk …” The same study also showed that Chinese investors prefer large markets within the OECD countries.

Firms, at least in the larger emerging markets such as India, Brazil, or China, have had considerable experience as the local joint venture or supply chain partner of multinationals that invested in emerging markets (Kedia & Mukherjee, 2009). From these collaborations, EMFs learned technology as well as advanced management skills (Yeung, 1997). There are several such examples of learning by EMFs, such as Lenovo’s learning of computer hardware design and Ranbaxy’s alliance experience with Eli Lilly. Learning, in a broader organizational capability sense, has three other dimensions for EMFs. The literature hypothesizes that EMFs possess networking skills and network connections with their governments, ethnic diaspora, and an internal network known as the “grupo” or business conglomerate.

The government-firm nexus is another variable in this field where the hypothesis for effect on performance or internationalization can go in either direction. Several of the EMFs are state-owned, or quasi-state-owned; and in some of the countries such as China, the government takes active actions promoting firms’ international growth (Luo & Tung, 2007). This support is manifested in preferential financing, tax incentives, discriminatory regulations, or political deals with foreign governments. At the same time, the legacy of the state in terms of managerial ineffectiveness and meddling hangs as a weight on some of these firms.

The second network advantage accruing to some EMFs derives from their ethnic and cultural ties. We suspect that this varies by home nation and over time. Early internationalizers, such as those from Hong Kong, China, Singapore, and early Latin American MNEs, appear to have enjoyed this ethnic network advantage in terms of marketing strategies, recruitment of personnel, and product designs (Yeung, 1994; Mathews, 2002). However, internationalization of Indian companies has been historically oriented towards developed countries, and the recent international expansion of Chinese and Taiwanese firms seems to be targeted at foreign customers and markets outside their cultural groupings.

The third network advantage enjoyed by many EMFs is their conglomerate, group, or family association (Kedia, Mukherjee, & Lahiri, 2006;
Yiu et al., 2007). Based on conventional developed market organizational structure thinking, unrelated diversification produces no net benefit for a company. However, in the case of emerging markets, it is not uncommon for firms to be affiliated to business groups (Kedia et al., 2006; Khanna & Rivkin, 2001), which is usually accompanied by a high degree of unrelated product diversification (Yeung, 1999). Business groups act as fillers of home nation “institutional voids” by creating efficient internal markets for capital, labor, technology, and products (Khanna & Palepu, 1997). Member firms can thus benefit from easy access to much needed capital and managerial expertise when internationalizing into foreign markets. Unrelated product diversification boosts domestic firm performance in certain emerging markets (Khanna & Palepu, 1999), in the process better preparing the firm to endure the usually costly initial internationalization process.

Business groups in emerging economies are often, although not necessarily, associated with family ownership. Although there are negative financial and governance aspects of closely held, familial shareholding, this is also hypothesized to foster a more entrepreneurial culture and long-term orientation compared with developed market firms (Gaur, 2007). However, a few studies suggest the opposite, that group affiliation is a liability for firms in emerging markets as the institutional environment in these countries develops (Gaur & Delios, 2006). Furthermore, the benefits accruing from group affiliation may not translate into similar benefits in a context where quality institutions are present (Gaur & Kumar, 2009).

The literature also identifies as an advantage what may best be described as “flexibility” or “adaptive responsiveness” on the part of emerging market managers as a response to their institutional or cultural environment. For example, Haier is famous for its willingness to redesign the washing machines to even include the washing of potatoes and vegetables in rural China – an adaptability that was then transferred into innovative niche designs for refrigerators sold in the United States. The creative circumventing of South African regulations became a managerial strength in SABMiller’s overseas expansion. Other related managerial attributes are “frugality” (Peng, 2001) and multiple pricing designed to cater to market segments with varying price sensitivities (Perez, Meier, & Woetzel, 1995).

Finally, there is near consensus that an important advantage accruing to EMFs is their low-cost home base, which makes them competitive as both exporters and direct investors. Firms no longer view exporting and FDI as strategic alternatives, but use them as simultaneous strategies. Any number of companies – from Mahindra-Satyam to Tata Consultancy Services based in India – have their marketing and customized service functions performed.
by their European and US subsidiaries, while the “production” part of the value chain is performed in India, East Europe, or China (Contractor et al., 2007). Such EMFs have learned to rationalize their value chain to maximize their competitive advantage.

IN SEARCH OF NEW THEORIES?

We began our review with the following question: Does internationalization of EMFs require a completely new explanation, or are existing theories sufficient? As we identify in our review, there are several aspects of the internationalization of EMFs that are different from the internationalization of developed market firms in important ways.

The internationalization of EMFs is not only different from that of developed market MNEs, but is also quite heterogeneous within developing-market MNEs. For example, the most recent crop of EMFs has been characterized by what is called as “accelerated internationalization” (Mathews & Zander, 2007). Mathews (2006) shows that internationalization of EMFs was not only very rapid and very different from that of the conventional western multinationals but also varied considerably from that of the erstwhile developing-country multinationals in the 1960s and 1970s. Firms from the Asia Pacific region like Acer, Ispat International, Li & Fung, Hong Leong Group, Lenovo, Samsung Electronics, and many others have surprised scholars, policy makers, and western managers by their fast-paced international expansion strategies. They defy the conventional view of incremental internationalization as proposed by the Uppsala school (Johanson & Vahlne, 1977).

Another key aspect of EMFs’ internationalization strategies is a greater propensity to use nontraditional international expansion strategies, such as the simultaneous use of exports and FDI (Contractor et al., 2007). Buckley et al. (2007) find strong statistical evidence that “… one of the key motivations of Chinese (outward) investment has been to promote domestic exports.” The historical or textbook version of “foreign market entry” used to entail a choice between exporting, licensing, and FDI as alternative means of reaching the foreign customer. But in today’s globally integrated world, where the value chain is disintermediated with functions dispersed over different geographical regions, exporting and FDI are frequently a combined and simultaneous strategy. Where a firm with international aspirations was traditionally supposed to first export and later engage in
FDI, many Indian and EMFs appear to be engaging simultaneously in both, early in the internationalization process.

In view of these differences, scholars have raised doubts about the applicability of existing theories to the internationalization of EMFs. There are three dominant views on this issue. The traditional school of thought still considers EMFs’ internationalization as being no different from that of large developed market MNEs, and that this can be satisfactorily explained by the OLI paradigm (Cantwell & Narula, 2001; Narula, 2006). They argue that the international success of a few firms from emerging markets that seem to defy the OLI paradigm, such as their ability to go abroad in spite of weak ownership advantages, is by no means an indication of a general trend or pattern. These EMFs that have turned into MNEs of the 21st century could simply constitute a group of outliers, and deriving new theoretical insights from them may be extremely risky and speculative (Narula, 2006).

A second school of thought considers that existing theories, particularly the OLI framework (Dunning, 1981, 1988), have enough elements in them to explain internationalization of a majority of EMFs; however, the OLI framework can be modified and strengthened to explain the unique aspects of EMF internationalization (Dunning, 2006; Luo & Tung, 2007). For example, Dunning and Lundan (2008) propose a theoretical framework that incorporates an institutional dimension into the three components of the OLI paradigm. This framework draws substantially from the work of North (1990) on institutions, and is an attempt to advance understanding of contemporary MNEs, many of which come from emerging markets.

The third school of thought considers the OLI framework to be totally insufficient, and proposes alternatives, such as the LLL framework by Mathews (2006). Their argument, to a large extent, is based on the notion that EMFs are internationalizing in spite of their extremely weak resource positions, which runs against the basic premise that firms need to possess at least some unique and sustainable resources or capabilities or market access in order to cross borders. Some scholars go on to suggest that recent advances in the international business activities refute the received wisdom of OLI framework, and we need an all-together new theory to explain the international business activities in the 21st century (Delios, 2007).

**CONCLUSIONS**

Our review proposes to address one of the significant research and management issues of our day, the internationalization of firms based in
emerging markets (Buckley & Ghauri, 2004; Peng, 2004). Thus far, the predominant focus of research has been on firms in developed markets, especially the United States, EU, and Japan, with relatively little knowledge about international firms from the emerging markets (Luo & Peng, 1999; Peng & Luo, 2000). Based on our review, we posit that EMFs do possess ownership advantages, albeit in a manner that is not easily discernible. For example, entrepreneurial ability and networking skills that allow EMFs to operate in harsh market conditions with little institutional support represent ownership advantages when venturing into international markets. Some of these advantages are country-specific, whilst others are firm specific. Also, EMFs have been nurturing these abilities and skills by substantial investments in research and training-related activities, by proactively seeking partnerships in domestic and international markets, and by innovating specifically for emerging market consumers.

As such, we view EMFs as entities that do possess ownership advantages, where advantages emerge from unique sources. More importantly, these ownership advantages currently might be small, but are bound to grow in scale and scope in the not so distant future. Location-based advantages as conceived in the traditional internationalization theories do persist, but are losing value as being the basis of competitive advantage for firms. Phenomenal improvements in communication and transportation technology have created a more level-playing field in global business for all types of firms, including those from emerging markets. Some EMFs have shown great prowess in adopting new innovative business models, sometimes quicker than developed market firms, for conducting business globally. The prosperous BPO (business process outsourcing) industry in India is an apt example of how EMFs are outcompeting their developed market competitors in an industry that is relatively more knowledge-intensive. Similarly, internalization advantages as hypothesized for developed market firms’ international success have given way to the ability of firms to foster strategic alliances globally. EMFs have utilized the strategy of linking up with other players in the global arena to learn and leverage from their relationships. As such, they have been able to enjoy most of the benefits that accrue from internalizing operations or products abroad, without having to take up the associated costs and risks.

EMFs have followed several strategies to internationalize. Considering dimensions such as sources of competitive advantage, industry conditions, target foreign markets, and modes of international expansion, a variety of different international strategy can be observed. Firms such as China National Offshore Oil Corporation (CNOOC) or Tata Iron and Steel that
have gone for major acquisitions can be described as “global acquirers.” Others such as Haier that pride themselves on product design adaptation to local customers can be described as “nimble adapters.” Others that are low-cost supply chain or alliance partners may be characterized as “low-cost global partners.” A handful of EMFs are already known to be developing cutting-edge technology. Examples are Suzlon (the world’s largest wind turbine developer) and Serum Institute of India, the fourth largest vaccine producer in the world. The “global innovator” label fits such (admittedly few) companies.

In a nutshell, while some aspects of EMF internationalization seem to be minor modifications of what developed market firms went through during their internationalization, there are many other aspects that are new and unique to EMFs. This warrants novel theoretical frameworks, which are more than just modifications to existing internationalization theories. In this sense, our view on EMF internationalization is most similar to the third school of thought (Delios, 2007) that seeks for alternative explanations for this new phenomenon. Although there is a growing academic literature, both theoretical and empirical, we have as yet no comprehensive picture in terms of aggregate data on EMF internationalization, or on the theoretical underpinnings of this phenomenon and the different globalization paths undertaken. Our paper hopes to focus scholarly thinking to assess competing explanations and theories and provide frameworks for further research.

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Internationalization of Emerging Market Firms


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