

Discussion Paper

The Modern MNE as an Efficient Meta-integrator: Emerging Market MNEs Need to Foster Internal Embeddedness to Succeed

May 2016

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Forthcoming: *International Journal of Technology Management*

Abstract

The modern MNE has to be a 'meta-integrator', able to leverage knowledge within and between its different constituent affiliates, which requires efficient internal markets and well-structured cross-border hierarchies. EMNEs will need to strengthen the ownership advantages necessary to achieve such internal embeddedness, which are hard to acquire, and must be learnt. I couch this discussion in the ongoing debate about the nature of ownership advantages. The ability to be competitive in an era of globalization depends as much on the EMNE's technological assets as it does on its ability to achieve economies of common governance. The EMNE (like all MNEs) has to be able to promote internal knowledge flows, both to and from the parent, as well as between affiliates located in different countries, and the ability to achieve organizational, scale and scope economies.

Acknowledgements

I wish to thank Jongmin Lee and Maite Bezerra for their research assistance. Comments from the editors are gratefully acknowledged. All errors remain my own.

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Introduction

The last decade has seen the discussion about emerging country MNEs (EMNEs) move towards to maturity. Summarising a wide literature, the general view is that EMNEs are governed by the same principles of international business and economics as their developed country counterparts, although all sides also accept that the provenance of a firm matters. The argument still ongoing is to what degree EMNEs have some innate advantage over other MNEs that allows them to do things differently, and whether these differences will persist. It has been my contention that an MNE's experience in internationalisation is more significant than its national origin, and that the core issue for an MNE to succeed in the longer run is its ability to acquire and leverage ownership advantages or firm-specific assets (FSAs) (I use both terms interchangeably throughout this paper) in a variety of locations simultaneously, and that this imperative trumps all others (Narula 2012, 2015, Cuervo-Cazurra 2012, Madhok and Keyhani 2012).

Much of the debate on EMNEs has focused on their weakness in technological assets, and the extent to which they possess other kinds of advantages that overcome this deficiency. These 'other' assets are often associated with the experience of working in institutional voids, the relevance of home country experience to foreign markets, and the ability to acquire and internalise technological assets from other firms rapidly. I do not dispute that there is some value to such assets, but feel these advantages are insufficient for the EMNE to succeed in the longer run. I return to basic international business (IB) theory to draw our attention to aspects of FSAs that have unaccountably been neglected in the discussion. Key among these is that a firm is 'multinational' only when there is a degree of active coordination and control of the foreign operations by the parent firm. The ability to establish international operations (whether through M&A or greenfield investments) does not automatically imply that a firm will efficiently manage these foreign affiliates. Indeed, some EMNEs have preferred to manage their foreign operations as a loose constellation of activities under common ownership (Wang et al 2013), given their weakness in the organisational skills needed to achieve *economies of common governance*. The modern MNE has to be a 'meta-integrator', able to leverage knowledge within and between the different constituent affiliates of its international network, which requires efficient internal markets and well-structured cross-border hierarchies.

I argue that these types of FSAs derive to a great degree from experience, and the newer EMNEs are deficient in these kinds of ownership advantages. Nascent MNEs (MNEs that are new at managing international activities) tend to lack internal organizational capabilities and are less able to actively manage (and rationalise) their foreign subsidiaries. The long-term success of the

current generation of EMNEs – like earlier ‘waves’ of EMNEs (Gammeltoft et al 2010) – depends crucially on their ability to promote internal knowledge flows, both to and from the parent, as well as between affiliates located in different countries, and the ability to achieve organizational, scale and scope economies. This is made no easier by institutional, organizational and technological distance. EMNEs will need to strengthen their FSAs necessary to achieve such internal embeddedness.

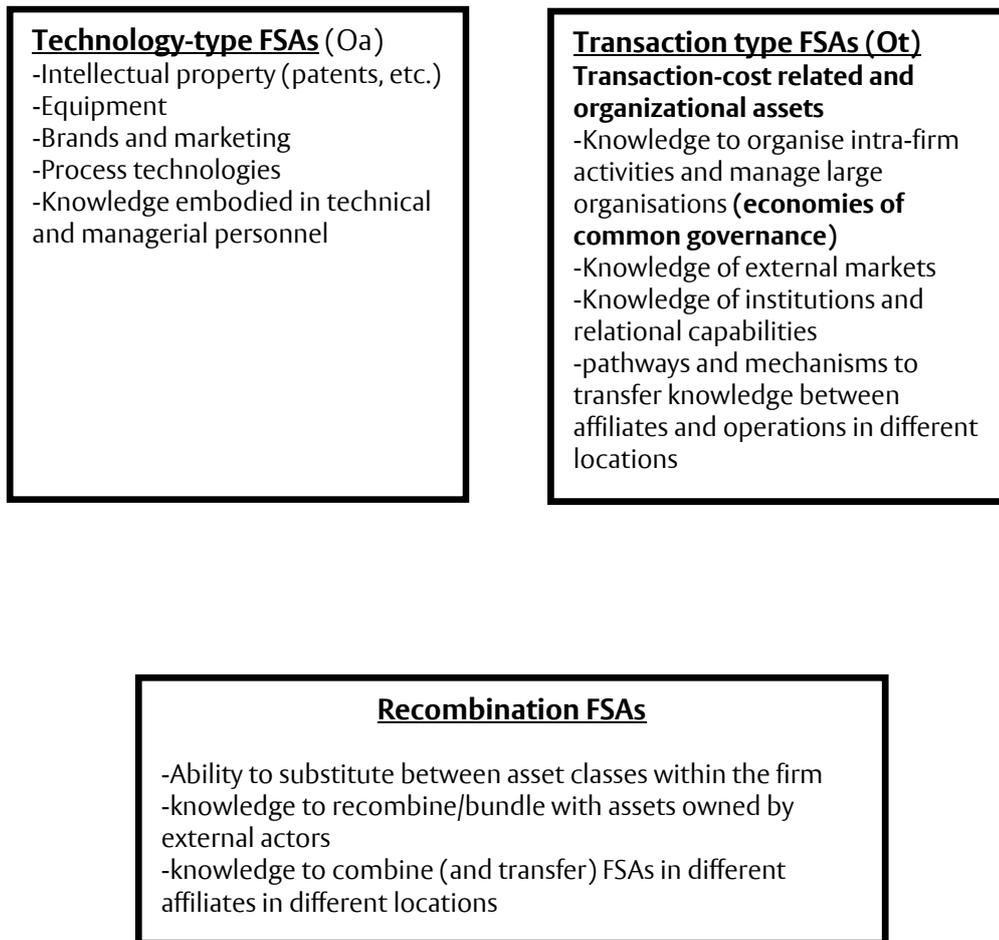
Ownership advantages and managing cross-border hierarchies

The concept of ownership advantages lies at the core of IB theory. Although there are some minor variations in the taxonomy of FSAs used by different authors (see e.g., Cantwell, Dunning and Lundan, (2009) versus Narula (2012, 2015) versus Rugman and Verbeke (2001), Groggaard and Verbeke (2012), Verbeke, (2009))¹, at the heart of the ownership advantage concept are two core subsets of assets (the nature of the third subset is in dispute), both of which are necessary for an MNE. The first is technology-type FSAs (Oa), which are typically associated with outputs from R&D, such as a patent, a process technology, or a brand, or embodied in personnel. Figure 1 summarises the attributes of Oa and Ot FSAs, as well as a third, less universally accepted category (figure 1).

Of equal importance is the second class of FSAs that relates to the firm’s ability to minimise transaction costs and organise its activities, known as transaction-type FSAs, or Ot). Apart from being able to exploit external market imperfections, the aspiring MNE needs to be able to manage its multiple operations (and internal markets) effectively. An MNE must be able to achieve *economies of common governance* (Dunning 1993, 2001). That is, it must have the ability to exploit its ownership advantages across locations, such that there are returns to managing multiple activities in several locations. For instance, an MNE may streamline certain activities (such as HR, or production) between countries to achieve lower costs. Indeed, the ability to exploit economies in the use of its knowledge or physical assets in several markets is a *raison d’être* for the modern MNE.

¹ For instance, the Cantwell et al (2009) view is that knowledge of institutions can be categorised as a separate FSA type (Oi), while Narula (2010, 2012) argues that these are part of transaction-type O assets (Ot).

Figure 1: A classification of firm-specific assets associated with MNEs



It is my opinion that the parents of many to the current generation of EMNEs may well have acquired some degree of expertise in managing networks of subsidiaries in the home country, but these FSAs are not always available to use abroad, for the very good reason that such assets may be *location-bound*, because they are specific to a particular location, often only at home, or in similar host countries, (Rugman & Verbeke, 1992, Carney et al 2016). Firms may internationalise in ignorance of whether these assets are transferable: it is not straightforward to determine which assets are location-bound, and which FSAs can be utilized abroad, and which sets of institutional knowledge are relevant in particular host countries. Indeed, in many instances it is only through failure that firms realise the limits applying their existing management and organisational expertise to new operations in new locations. It must be able to transfer this knowledge from parent units to subsidiaries. That is, to prosper, the MNE must be able to diffuse its FSAs to its subsidiaries, maximise the returns on its collective FSAs, and to lower costs on an MNE-wide basis ([Schleimer & Pedersen, 2013](#)).

The modern MNE as a meta-integrator

I have described the MNE elsewhere as a ‘meta-integrator’ (Narula 2014). It must manage knowledge resident within the MNE, and extract an advantage from it (Madhok 2015). The modern MNE requires the capability to recombine diverse knowledge sets, and this includes assets that are part of different affiliates within the same MNE or firm, or to combine assets that are located inside the firm with those outside the firm, whether these are part of the L advantages of its location, or part of the FSAs of an independent firm.

As such, a crucial aspect of a MNE’s ability to generate rents from cross-border hierarchies is the ability to move information from location to another to maximise its usage and value. However, transferring knowledge between two establishments located in different countries is fraught with difficulties. Although it is assumed that the MNE is an especially efficient mechanism to transfer assets to and from its various geographically dispersed subsidiaries (Kogut & Zander, 1993), this is not always so. MNE internal markets *in general* are considered to be more efficient than markets in transferring knowledge, but this does not mean that they are *always* more efficient. The ability to organise intra-firm transactions is an FSA that is essential for a firm to become a sustainable MNE, but such expertise is not easily acquired, and this largely relies on learning-by-doing. Younger MNEs tend not to have the knowledge to systematically ‘translate’ and transfer managerial practices and rent-generating FSAs abroad on a systematic basis (Narula 2014). Without this FSA the MNE is simply a multi-locational collection of free-standing establishments held together by common ownership. The capacity to recombine assets

A number of recent conceptual contributions have highlighted that moving and utilising assets between various internal units of the MNE and external actors require what are known as recombination advantages (figure 1). These allow the firm to ‘recombine’ assets to create a new ‘bundle’ by substituting other internal (or external) assets to achieve a similar outcome (Verbeke 2009, Hennart 2009). Firms can overcome a weakness in one set of assets (say, for an airline, new energy efficient aircraft) by strength in another type of FSA (e.g., a superior aircraft logistical system to maximise aircraft use). For an EMNE, the ability to organise intra-firm transactions more efficiently, or to acquire resources from external markets at lower prices may help overcome the weakness in technology-type FSAs. Conversely, a strong portfolio of proprietary technologies may compensate for poor knowledge of markets or inefficient management. An EMNE can overcome the absence of unique technologies by being able to organise its intra-firm transaction so efficiently that overall it still generates a cost advantage (Collinson & Narula, 2014). This is akin to entrepreneurial capacity, and reflects an ‘agility’ that MNEs can have which

allows them through 'entrepreneurial endeavor to overcome the advantage deficit' they may suffer (Madhok 2015). It involves having an intricate knowledge of the assets available (and those unavailable) in each of its operations, an understanding of their location-boundedness, their value (vis-à-vis external alternatives), and the mechanisms to transfer them effectively from one location to another.

Being able to move knowledge *efficiently* between establishments is crucial for the EMNE, just as it is for other MNEs. This internal knowledge transfer is facilitated by the affiliate's 'internal embeddedness' (Meyer et al 2011, Narula 2014). Internal embeddedness crucially requires both parties to be willing to transfer, so one must be willing to 'give' and the other to 'receive' (Gupta & Govindarajan, 2000). Transferring knowledge also depends upon both parties having similar levels of absorptive capacity.

EMNEs have shown a propensity to expand internationally through acquisitions. Knowledge acquisition by this means has its disadvantages. A recently-acquired establishment in a given location may be an 'outsider' to the MNE (Monteiro, Arvidsson, & Birkinshaw, 2008) and such acquired subsidiaries often have no internal embeddedness. Employees of acquired subsidiaries are viewed with some suspicion by existing staff, and vice versa. There is considerable organisational inertia, especially in the area of R&D, and key individuals may show a reluctance to engage in R&D cooperation with former rivals (Criscuolo and Narula 2007). Blomkvist et al (2014) find that there are still tangible differences between acquired and greenfield subsidiaries even after 100 years. As Mudambi et al (2014) note, a common culture is important in transferring tacit knowledge. Knowledge is context-specific (and location-specific) so that there is need for common contexts of experience between sender and recipient to convert the transferred (and often tacit) knowledge to explicit knowledge (Nonaka, Toyama and Konno 2000). Just because there is common ownership does not mean that the two establishments have the same context of experience, unless the subsidiary is populated mainly by expatriates from the home country. Indeed, this is why a number of nascent MNEs have relied upon a large contingent of expatriates in the senior management and technical personnel of the home country (Perez and Pla-Barber, 2005, Tan and Mahoney 2006, Beamish and Inkpen 1998). Such transplant subsidiaries are ultimately not sustainable, because the costs of a transplant strategy outweigh the benefits in the long run.

This brings me to the issue of 'bandwidth'. Internal embeddedness is not simply a matter of 'pathways' between parent and subsidiary, it is also about their 'bandwidth', or the width of these pathways. High bandwidth connections imply regular, efficient and intensive two-way knowledge flows, for instance through systematic face-to-face engagement between scientists,

engineers and managers in different units. High bandwidth links are resource-intensive and take time to establish (Narula 2014). Where the FSA to be shared is associated with tacit knowledge, greater bandwidth is required, especially when the knowledge is embodied in technical personnel.

Closing remarks

I have tried to highlight that managing an MNE is no simple process, and a viable MNE requires mechanisms for efficient coordination, control, in addition to internal pathways for knowledge flows between its various geographically dispersed activities. Knowledge transfer depends on creating the appropriate routines, and these need to be codified in some way for them to be transferred. The literature on EMNEs has neglected that distances matter *within* an MNE as well. Creating efficient internal pathways and networks is no easy task, and achieving economies of common governance matters even more in a world of intense international competition. Unfortunately, there has been relatively little research into understanding how EMNEs can do so effectively, possibly because these types of firm-specific assets are difficult to quantify and objectively evaluate *ex ante* as to whether they are location-bound or not. This is a rich and unexplored area for research. How do MNEs learn to organise themselves efficiently? What mechanisms can be employed to internalise this knowledge from acquired operations? How do firms avoid organizational inertia? What are the limits to using expatriation as a means to transfer organizational practices and routines?

Many previous generations of EMNEs have stumbled at this very hurdle. Initial rapid expansion by Japanese MNEs in the 1980s faced the hurdle that Japanese organisational practices (which were the primary ownership advantage of Japanese firms) were not easily transferable to other countries. Many of the current generation of EMNEs that have sought to rapidly expand internationally will likely also stumble if they cannot create coherence and structure that permits them to derive economies of scale, scope and common governance across their geographically dispersed constellation of affiliates.

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