Manag Int Rev (2012) 52:193–212
DOI 10.1007/s11575-012-0134-3

RESEARCH ARTICLE

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Management
International Review

Acquisitions by EMNCs in Developed Markets

An Organisational Learning Perspective

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Abstract:

- Building on an organisational learning perspective, we argue that emerging market firms' international experience and home-country characteristics are core sources of learning. Furthermore, we argue that these factors constitute important determinants of emerging market firms' acquisition behaviour in developed countries (south-north acquisitions).
- We test our hypotheses on a sample of 808 south-north acquisitions. The acquisitions were undertaken in Europe, Japan and North America (Canada and the US) between 1999 and 2008 by firms from the emerging economies of Brazil, Russia, India and China.
- As suggested by the internationalisation process model, our results show that emerging market firms undertake acquisitions in developed countries in an incremental fashion. Acquisition experience in developed markets increases the likelihood of exploitative expansion, while acquisition experience in developing markets does not appear to have any effect. The results also show that a lack of market and knowledge-based resources at home curbs explorative acquisitions by firms in emerging markets.

Keywords: Emerging markets · South-North acquisitions · Organisational learning · Home-country characteristics · International experience · Related and unrelated acquisitions · Exploration and exploitation

Received: 30.03.2010 / **Revised:** 31.05.2011 / **Accepted:** 07.06.2011 / **Published online:** 16.03.2012
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Introduction

Multinational corporations from emerging countries (EMNCs) are not only growing at a faster rate than most multinational corporations (MNCs) from developed economies but, in recent years, they have also invested massively abroad: Foreign direct investment (FDI) from emerging markets represented 16% of global FDI flows in 2008 and 28% in 2010 (UNCTAD 2011). The foremost example of this "seismic shift in global business" is probably Lenovo's acquisition of IBM's personal computer business in 2005.[1] At the time, Lenovo was a little-known Chinese corporation but it has since become the world's fourth-largest PC manufacturer.

Firms from emerging countries have traditionally served as targets rather than acquirers in cross-border acquisitions. However, they are progressively becoming more active in acquiring firms in developed economies (Cantwell and Barnard 2008; Sauvant 2008; Duysters et al. 2009). In 2010, cross-border mergers and acquisitions accounted for 30.7% of the outward FDI (OFDI) flow from developing economies, while the corresponding figure from developed economies was only 25.2% (UNCTAD 2011). The sizeable gap in technological and marketing capabilities between developed market firms and emerging market firms tends to translate into the exclusion of EMNCs from alliances with stronger partners in the industry. Even when EMNCs are able to establish alliances with stronger partners, they are likely to possess weaker bargaining power over knowledge spillovers. In contrast, acquisitions always give the acquirer more control over the returns from the acquired strategic assets (Athreye and Godley 2009). Therefore, "south-north acquisitions" represent an important way for emerging market firms to expand their activities, and to acquire and develop tangible and intangible resources (Luo and Peng 1999; Hitt et al. 2005; Wright et al. 2005; Thomas et al. 2007). Yet, entering a new cultural bloc—such as developed markets—does not come without costs. EMNCs are exposed to new rules, procedures, conventions and ways of doing business (Johanson and Vahlne 1977, 2009).

The literature suggests that organisational learning, that reduces entry barriers in foreign markets, favours the gradual entry of firms in other markets (Johanson and Vahlne 1977; Barkema and Vermeulen 1998; Luo and Peng 1999; Thomas et al. 2007), and substantial international experience is needed to benefit from a foreign venture (Barkema and Drogendijk 2007). This study adds to the literature by testing whether the prediction of an incremental internationalisation pattern is valid for EMNCs that have decided to enter a developed market. Entry into a foreign market may be pursued through either an explorative or an exploitative strategy. Exploration refers to processes "involving search, variation, risk taking, experimentation, play, flexibility, discovery, innovation", while exploitation captures processes of "refinement, choice, production, efficiency, selection, implementation, execution" (March 1991, p. 71). A key dimension along which explorative and exploitative acquisitions typically differ is the sectoral distance between the acquirer and the target: related acquisitions are typically exploitative, while unrelated acquisitions are more explorative in character (Pennings et al. 1994). Therefore, the propensity of EMNCs to engage in related acquisitions (rather than unrelated acquisitions) indirectly reflects their pursuit of a more exploitative (incremental) than explorative (taking larger steps) foreign expansion.

On the basis of the organisational learning perspective, we develop a set of hypotheses about the determinants of related and unrelated acquisitions undertaken by EMNCs in developed markets. First, following the extant literature on organisational learning and international expansion (e.g., Johanson and Vahlne 1977; Barkema and Vermeulen 1998; Luo and Peng 1999), we analyse how a firm's international experience influences the acquisition strategy of an EMNC. Second, we posit that home-country characteristics constitute a core component in the learning behaviour of emerging market firms. Contextual factors, such as the development of market institutions, the enforcement of property rights, industry structure and firm ownership, are generally assumed to have a significant influence on firms' strategic decisions (Wright et al. 2005; Buckley et al. 2007). In this regard, emerging market firms may be at a disadvantage as a result of shortcomings in their institutional environment, which limit their technological and commercial development (Hitt et al. 2000; Moon and Roehl 2001). On the other hand, emerging market governments are increasingly promoting a wide range of policies that either directly encourage OFDI (Buckley et al. 2007) or indirectly favour competition on a more global level (Chittoor et al. 2009). The latter measures might include enforcing the protection of technological competencies, ensuring the development of market factors and improving institutions. This evolution in the institutional setting of emerging markets allows us to examine how differences in the learning opportunities of emerging market firms influence EMNCs' acquiring behaviours in developed markets.

We test our hypotheses on a set of acquisitions in developed economies undertaken by firms from the emerging economies of Brazil, Russia, India and China (the BRICs). We provide micro-level evidence of different determinants of related and unrelated acquisitions using a cross-sectional dataset consisting of 808 acquisitions that were undertaken by the BRICs in Europe, Japan and North America (Canada and the US) between 1999 and 2008.

This study contributes to the international business (IB) theory on the EMNC internationalisation process in two ways. First, a recent, but well-established, line of research questions whether theories that have been developed through studies of advanced market MNCs can also explain FDI undertaken by MNCs in emerging markets (Mathews 2006; Li 2007). Drawing on the organisational learning perspective, we evaluate whether the determinants of acquisitions by EMNCs in developed markets are aligned with the internationalisation process model (e.g., Johanson and Vahlne 1977). Second, recent research suggests a need to pay more attention to the role of home-country characteristics in the internationalisation of firms from emerging countries (e.g., Rugman and Li 2007; Kalotay 2008). Therefore, we extend the learning argument by considering the characteristics of the home country environment as an important source of knowledge that, from an organisational learning perspective, complement a firm's prior international investment experience.

The Nature of South-North Acquisitions: Exploitation versus Exploration

Acquisitions are often categorised on the basis of acquirer-to-target relatedness, which refers to the degree of association between an acquirer and its target (e.g., Rumelt 1974).

Firms use related investments to increase their market power through economies of scale, to pursue strategies of diversification through economies of scope, or to increase cost efficiency through backward or forward industrial integration (Singh and Montgomery 1987). The resource-based view emphasises the importance of fungible resources and capabilities that can be transferred and used in different contexts. As related acquisitions expose firms to stimuli that fall within their organization's familiar cognitive setting, they are expected to offer an array of opportunities and challenges that are suitable for exploitation. Such opportunities include business prospects related to the firm's current knowledge domains. In this regard, exploitation refers to the improving and refining of the existing product-market domains or technological trajectories (March 1991). Related investments are an important way for an acquiring firm to extend its activities to similar and/or complementary products and/or markets. The greater the overlap between the acquiring and acquired firms, the lower the integration costs, the higher the efficiency gains through the exploitation of potential synergies, and the better the strategic and technological fit (Buckley and Ghauri 2002; Dunning and Lundan 2007). EMNCs can therefore advance their global interests by engaging in exploitation (related) acquisitions to gain access to complementary assets, such as distribution centres and retailers through which their goods or services are sold (e.g., Athreye and Godley 2009). Accordingly, market seeking, resource seeking and strategic asset seeking investments are more likely to be exploitative in nature when undertaken through related acquisitions.

Conversely, entering unrelated businesses is an explorative move. Exploration calls for variation, risk taking, experimentation, discovery and innovation. It includes entrance into a new product-market domain, or a development of or shift to a new technological trajectory (March 1991). When a firm undertakes an unrelated acquisition, the cognitive distance between the acquiring and the acquired firms is significant and explorative learning is enhanced (Wright et al. 2005). Expansion into unrelated businesses is characterized by more risk and a higher likelihood of failure (Pennings et al. 1994). Firms pursuing unrelated acquisitions may find it difficult to build upon existing knowledge and routines. However, as such acquisitions involve knowledge that is largely unrelated to the organization's familiar cognitive setting, they foster the firm's ability to comprehend and handle new opportunities, and increase the variety of events to which the firm is exposed (Luo and Peng 1999). This departure from the firm's knowledge base promotes experimentation; encourages access to new markets, resources and products; and facilitates learning beyond the current knowledge boundaries (Gavetti and Levinthal 2000). Accordingly, market seeking, resource seeking and strategic asset seeking investments are more likely to be explorative in nature when undertaken through unrelated acquisitions.

Based on these arguments, we view EMNCs entering developed countries through unrelated acquisitions as an example of an exploratory move, while related acquisitions represent a strategy of exploitation, which involves a more incremental commitment. We make use of important notions of the internationalisation process model (Johanson and Vahlne 1977; Barkema and Drogendijk 2007) to argue that EMNCs enter developed markets either incrementally by pursuing related acquisitions (i.e., refinement of the firm's existing knowledge base and a lower level of risk associated with the international venture) or by taking larger steps through acquiring firms in unrelated businesses (i.e., greater

departure from the current organisational cognitions and experiences, and a higher level of risk associated with the international venture).

Organisational Learning and South-North Acquisitions

The resource-based view posits that a firm's strategy is influenced by its exposure to, and experience with, different sources of knowledge (Cohen and Levinthal 1990; Zahra and George 2002). A firm's ability to explore and acquire new knowledge is path dependent (Cohen and Levinthal 1990), and it is influenced by its exposure to diverse, external sources of knowledge (Zahra and George 2002). Learning is a prominent concept in international management, as a lack of knowledge obstructs multinational expansion (Johanson and Vahlne 1977; Barkema and Vermeulen 1998; Luo and Peng 1999; Thomas et al. 2007). Furthermore, entrance into a new foreign region "is fraught with problems, and […] expansions will likely suffer from a liability of foreignness" (Barkema and Drogendijk 2007, p. 1134). Therefore, the internationalisation process model indicates that firms internationalise gradually and that this gradual internationalisation allows them to gain from organisational learning. Specifically, this organisational learning is associated with the firm's prior foreign experience and with the knowledge it has developed abroad (Barkema and Vermeulen 1998). Firms can accumulate knowledge through learning-by-doing and their own experiences that can help them overcoming the initial liability of foreignness. This leads to path-dependent internationalisation patterns (e.g., Johanson and Vahlne 1977). The relevance of accumulated experience strengthens when the foreign region is not a neighbouring one (Johanson and Vahlne 1977, 2009).

However, in addition to the need to address the challenges of entering a new cultural bloc, EMNCs investing in developed markets must choose whether to remain within the industry with which they are familiar (i.e., an exploitative move) or to enter unfamiliar businesses (i.e., an explorative move). We expect EMNCs' capacities to reduce cognitive barriers to foreign entry—i.e., their organisational learning—to be beneficial when entering a developed market, and to be a determinant of whether EMNCs will enter incrementally or in larger steps. If a firm expands abroad in related businesses, it can transfer and replicate existing organisational routines to fit the new foreign situation and minimise the risk of failure (Barkema and Vermeulen 1998). In contrast, the replication and adoption of existing routines is more difficult, costly and risky when a firm pursues an unrelated expansion. In other words, international business diversification can be more or less incremental depending on whether firms invest in related or unrelated businesses. Learning through geographical diversification provides knowledge about how to handle the liability of foreignness (Johanson and Vahlne 1977), while learning through acquisition enables firms to develop the capabilities necessary to manage the acquisition process (e.g., Larsson and Finkelstein 1999; Buckley and Ghauri 2002). Accordingly, we expect a firm's international acquisition experience to be an important determinant of acquisitions by EMNCs in developed markets.

However, we move beyond this basic direct assumption to suggest that the home-country environment can also affect firms' learning behaviours. From institutional theory, we know that institutions affect firm strategy and performance (Peng et al. 2008).

Local institutional environments provide the context in which firms operate and compete. Accordingly, firms develop knowledge and accumulate experience through industry, governmental and social relations that reflect the institutional constraints and/or opportunities they face at home. Most research indicates that EMNC FDI cannot be understood without considering home-country characteristics (Cuervo-Cazurra 2007; Rugman and Li 2007; Cantwell and Barnard 2008; Kalotay 2008). For instance, Kalotay (2008) proposes that FDI from emerging countries should be viewed within an OLIH paradigm, in which the *H* refers to the importance of home-country characteristics. Such characteristics are shaped by the local institutional context. Underdeveloped institutions create an adverse environment in which to nurture the organisational and technological resources needed to compete in foreign markets (Hitt et al. 2000; Cuervo-Cazurra 2007). These institutional factors may include a lack of adequate market sophistication, as well as a lack of scientific institutions, skilled labour, research and development facilities, management training institutes and other supply side typological characteristics that support firms' learning opportunities and, accordingly, the development and sustainability of firms' competitive advantages.

Emerging markets are increasingly exposed to a profound institutional transformation that is diluting the relative differences between the institutional environments of emerging and developed countries. This evolution allows us to compare how differences in the institutional settings of emerging markets influence EMNCs' acquiring behaviours in developed markets. A dynamic change in government policies that supports (or hinders) firms' access to local key inputs could contribute to an explanation of EMNCs' learning opportunities and their foreign investment choices. Accordingly, we consider home-country market sophistication and knowledge-based resources as important determinants of acquisitions by EMNCs in developed markets.

Determinants of South-North Acquisitions: Hypothesis Development

We expect a firm investing in a developed country through related acquisitions to benefit from knowledge it has obtained through previous international acquisitions. Hence, we expect prior experience in international acquisitions to be consistent with an incremental internationalisation strategy, i.e., a strategy of exploitation, for several reasons.

First, acquisitions are complex strategic investments that require a range of decisions about the integration of the acquired firms. These include decisions related to such aspects as restructuring and material flows, as well as decisions about the extent of coordinative and communication efforts (e.g., Capron 1999; Graebner 2004; Zollo and Singh 2004). Firms with prior acquisition experience are more efficient in managing pre-acquisition evaluation and targeting processes, and in effectively implementing post-acquisition reorganization and integration processes (Pennings et al. 1994; Hitt et al. 1998; Buckley and Ghauri 2002).

Second, acquiring firms with acquisition experience in diversified geographical markets are more likely to be able to evaluate their "strategic fit" with a potential target firm (Larsson and Finkelstein 1999). In line with absorptive capacity theory (Cohen and Levinthal 1990), the greater the prior related knowledge of a firm, the greater its com-

petence in selecting appropriate target firms, and consequently combining and exploiting the acquired knowledge. EMNCs with international acquisition experience are likely to be more familiar with local suppliers and customers, competitors and governments, and to have developed tacit knowledge about promotion channels, market segments, and marketing and distribution networks (Luo and Peng 1999; Johanson and Vahlne 2009). Therefore, emerging market firms with international acquisition experience should be better able to find and evaluate critical information about various aspects of the target firm, such as its customers, technologies and market demand, so as to improve and refine their activities and businesses. Therefore, we propose the following relationship:

Hypothesis 1a: The higher the international acquisition experience of developing market firms, the more likely they are to undertake related acquisitions than unrelated acquisitions in advanced markets.

Different types of international experience enhance different forms of knowledge gained by investing firms (Thomas et al. 2007). Emerging market firms typically exist in unstable, turbulent institutional and economic environments, which makes it easier for them to invest in similar developing economies (Deng 2003; Hong and Sun 2006; Rui and Yip 2008; Ramamurti 2009). However, a tendency to expand only within similar institutional and resource environments would not only prevent investing firms from seeking a diverse range of knowledge, but it would also limit their experience and knowledge to developing countries. When emerging market firms acquire firms in other emerging markets, the acquiring firms' knowledge of foreign rules, routines and conventions is only refined and incrementally improved (Johanson and Vahlne 1977; Luo and Peng 1999; Barkema and Drogendijk 2007).

In contrast, in a study of Korean and Taiwanese firms, van Hoesel (1999) finds that investments in developed markets are more likely when the acquiring firms have extensive OEM (original equipment manufacturer) contracts or alliances with MNCs from developed countries prior to the investment. A similar result is presented by Makino et al. (2002), who consider strategic asset-seeking investments made by firms from newly industrialized economies. When acquisitions are undertaken in foreign environments that differ from the home country, the acquiring firm can take advantage of new opportunities to learn different conventions, routines and procedures, which can translate into knowledge about new cultural settings (Barkema and Drogendijk 2007). This allows the investing firm to develop new absorptive capacities (Zahra and George 2002). Accordingly, we expect familiarity with the cultures and business practices of developed economies to be more relevant than knowledge about developing countries for emerging market firms wishing to engage in related south-north acquisitions. Therefore, we suggest the following:

Hypothesis 1b: The more international acquisition experience developing market firms have in advanced markets, the more likely they are to undertake related acquisitions than unrelated acquisitions in advanced markets.

Our arguments imply that Johanson and Vahlne's (1977) hypothesis of internationalisation in incremental fashion is valid for EMNCs investing in developed markets. Support for hypotheses 1a and 1b would imply that when expanding in developed markets, the

incremental expansion pattern of EMNCs (via exploitative, related acquisitions) would benefit from firms' previous international acquisition experience.

We posit that the nature of the home-country environment influences a firm's learning processes and that it should therefore be viewed as an important determinant of EMNCs' acquisition behaviour in developed markets. A firm's perception of what is relevant and valuable in a host country tends to be constrained by the home country's knowledge base and technological specialisation (Cantwell and Janne 1999). When factor markets are well developed, local firms can access key inputs, such as well-trained human capital, market sophistication, technological resources and financial resources. In such contexts, the sophistication of local customers and the fast changes in consumer demand expose firms to a rich array of opportunities, which forces them to continuously improve, thereby leading to higher innovation levels (Porter 1990). Firms from countries with plentiful human and technological capital learn how to access to well-trained scientists and capital through the market, and are therefore better able to tap into the technological expertise of their host countries and use strategic resources. Thus, improvements in the home-country environment are likely to expose EMNCs to broader and diverse external sources of knowledge that positively influence their absorptive capacities. Greater home-country advantages amplify the breadth of learning opportunities and permit learning of different ways of doing things. In sum, we expect a higher level of home country market sophistication and knowledge-based resources to enhance the diversity of EMNC experience, leading to more opportunities for exploration (March 1991; Luo and Peng 1999).

On the other hand, when the local market is underdeveloped, local firms are not exposed to a rich set of demand characteristics that can develop and enhance their firm-specific competencies. Firms that deal with simple, non-demanding customers face a limited range of challenges, which in turn limits their knowledge structure and technological capabilities (Barkema and Vermeulen 1998). When investing abroad, firms from lower-order competitive environments simply extend their efforts in what are already their main lines of business (Cantwell and Janne 1999). An exploitative move is a less costly and less risky option. Thus, when the home-country resource environment is deficient in skilled labour, patents, research and technology, the variety of new opportunities and ideas to which EMNCs are exposed decreases and foreign investments are likely to be more exploitative in character. Based on this reasoning, we suggest that:

Hypothesis 2a: The higher the level of the home-country market sophistication, the more developing market firms are likely to undertake unrelated acquisitions than related acquisitions in advanced markets.

Hypothesis 2b: The higher the level of home-country knowledge-based resources, the more developing market firms are likely to undertake unrelated acquisitions than related acquisitions in advanced markets.

Support for these hypotheses would imply that the home-country environment can serve as an important source of knowledge. In particular, by improving the home-country market sophistication and knowledge-based resources, emerging market governments are likely to increase the breadth of learning opportunities to which local firms are exposed. Consequently, such moves should promote more explorative, ambitious foreign expansions.

Method

Data and Sample

Our sample is drawn from the population of acquisitions undertaken by firms from the BRIC countries in Europe, North America and Japan between 1999 and 2008, as reported in the Thomson ONE Banker database (Thomson Financial). The 1,138 deals that constitute the population were meticulously screened to draw our sample. First, we exclude deals that can be associated with round-tripping (i.e., "the channelling by direct investors of local funds to SPEs (special purpose entities) abroad and the subsequent return of the funds to the local economy in the form of direct investment", IMF 2004, p. 70). Round-tripping flows encompass "spurious" FDI that is driven more by regulatory differences ("legal arbitrage") than by economic motivations. Notably, two of the most celebrated countries in which round-tripping is common are China and Russia (see Kalotay 2008).

Second, we exclude acquisitions undertaken by hybrid south-north firms—BRIC companies ultimately controlled by non-BRIC parents. This ensures that our analysis is not affected by the presence of a non-BRIC firm on the headquarter level, as hybrid EMNCs could rely on the mother company's country-specific advantages and experience. We also exclude hybrid south-south BRIC companies (i.e., controlled by a parent in another BRIC country). In other words, for the sake of homogeneity, we consider only "pure" EMNCs—firms that are either independent or controlled by another firm within the same country. We also exclude those deals undertaken by individual investors (directly or through family holdings), as such investments are structurally different from acquisitions undertaken by corporate investors.

After applying this screening process, we arrive at a final set of acquisitions made by "pure" BRIC corporations in Europe, North America and Japan between 1999 and 2008. The sample includes 808 south-north acquisitions.

Measures

We use a well-established measure of acquirer-to-target relatedness (see, among others, Haunschild 1994; Capron 1999; Haleblian and Finkelstein 1999) to distinguish between related and unrelated acquisitions. First, an acquisition is coded as *related* if the acquiring and the acquired firms have at least one two-digit SIC code in common at the time of the acquisition. Second, forward and backward vertical acquisitions are also coded as related. Following Haunschild (1994) and Haleblian and Finkelstein (1999), we define an acquisition as forward vertical when the industry of the acquiring firm sells more than 5% of its output to the industry of the acquired firm. Similarly, we define an acquisition as backward vertical when the industry of the acquiring firm receives more than 5% of its input from the industry of the acquired firm. To operationalise this measure, we use the input/output tables published annually by the Bureau of Economic Analysis of the US Department of Commerce.[1] Finally, acquisitions that are not classified as related are classified as unrelated. Therefore, the dependent variable *related acquisition* equals one when the emerging market firm has undertaken a related acquisition in a developed market and takes the value of zero when the acquisition is unrelated.

In terms of the home-country characteristics, we use a factor analysis, which allows us to take multiple highly correlated indicators (source: The World Bank Database[2]) into account to explain the level of the home-country market sophistication and knowledge-based resources. One dimension typically used to reflect the home-country market conditions is per capita gross domestic product (GDP-pc; e.g., Buckley et al. 2007). High levels of per capita GDP are normally associated with advanced market-based economies, which rely on complex and modern political, economic and juridical rules and institutions. The following indicators serve as possible proxies for the knowledge-based resources: (i) exports of high-tech goods as a percentage of GDP; (ii) number of patent applications from residents; (iii) royalties and fees paid; and (iv) FDI inflows. The first two indicators reflect countries' knowledge output, which is either embedded in technological products or codified in patents. The third indicator serves as a measure of knowledge input because it reflects the codified knowledge that is purchased by each country. The last variable proxies for tacit knowledge that emerging countries have acquired through FDI inflows. It is widely acknowledged that inward FDI gives rise to knowledge and technology spillovers, which flow to host countries through several channels, such as competition, demonstration, labour turnover, and backward and forward linkages (e.g., Blomstrom and Kokko 2001). Home-country characteristics are lagged by one year with respect to the deal (i.e., for a deal occurring in year *t*, we consider home-country characteristics in year *t-1*). This allows us to circumvent endogeneity problems that could arise from unobserved factors simultaneously affecting a country's general economic condition and the acquisition decisions of local firms (e.g., a major regulatory change).

Table 1 shows that our measures form two distinct factors. The first is explained by the four variables that account for the level of knowledge-based resources of the home country, while the second is explained by per capita GDP. We call the first factor *home-country knowledge-based resources* and the second *home-country market sophistication*. The variation of these two variables across time is reported in Table 2.

We gauge firm's *international acquisition experience* by measuring the number of foreign countries in which the EMNC engaged in acquisitions from its foundation until the year before a focal deal (source: Thomson Financial). We take the natural logarithm

Table 1: Operationalization of home-country advantages

Variable	Home-country knowledge-based resources	Home-country market sophistication
Export of high-tech goods as a percentage of GDP	0.91	−0.07
Number of patent applications from residents	0.98	0.07
Royalties and fees paid	0.98	0.13
Inflows of foreign direct investments	0.95	0.12
Per capita GDP	0.07	0.99
Eigenvalue	3.68	1.00
Cumulative variance	0.74	0.93

Table 2: Distribution over time of home-country advantages

Variable	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Home-country knowledge-based resources	−0.46	−0.41	−0.20	−0.16	−0.23	0.03	−0.05	−0.03	−0.02	0.33
Home-country market sophistication	−0.58	−0.78	−0.41	−0.61	−0.35	−0.36	−0.27	0.05	0.12	0.69

of (1 + *international acquisition experience*) to reduce the skewness of the original values and capture the fact that experience is likely to exhibit decreasing returns to scale. Again, the use of a lagged variable should limit endogeneity problems. On the basis of the discussion in the previous sections we distinguish among different types of experience and, hence, different types of absorptive capacity. We define two dummy variables: *Developed market acquisition experience* and *developing market acquisition experience*. The former equals one if the emerging market firm had undertaken at least one previous acquisition in developed countries, while the latter takes the value of one if the emerging market firm had previous acquisition experience in its home country or in other developing markets.[2] Clearly, the two dummy variables are not mutually exclusive, as at the time of a deal an EMNC may have already undertaken investments in both advanced and developing economies. Each variable is based on the deals conducted one year or more before the focal acquisition.

The variable *acquirer industry diversification* is measured by taking the logarithm of one plus the number of different two-digit industries in which the emerging market firm operates in the year before it makes an acquisition in a developed market. This variable allows us to control for sectoral diversification (e.g., Elango and Pattnaik 2007).

State ownership is also important when attempting to explain strategies of acquisition through diversification. State-owned firms may operate in a "special market space" that can alter their acquisition behaviour (Buckley et al. 2007; Luo and Tung 2007; Cui and Jiang 2009). Accordingly, we create a dummy variable (*state-owned acquirer*), which is equal to one when the acquiring emerging market company is controlled by the state.

The industries of the target firm are categorised in terms of technological intensity based on the average R&D spending in each industry (Cantwell and Barnard 2008). The following categories are included: (i) resource based, (ii) general service, (iii) knowledge-intensive service, (iv) low research-intensive manufacturing, (v) medium research-intensive manufacturing, and (vi) high research-intensive manufacturing.[3] High-tech and knowledge-intensive industries serve as an essential source of new products and technologies. Thus, we control for whether the target firm operates in a high-tech, medium-tech or knowledge-intensive industry, and we use low-tech and low knowledge-intensive sectors (i.e., resource-based, low research-intensive manufacturing and general service) as a benchmark.

Lastly, a factor that is often found to influence firm's acquisition decision and performance is the cultural distance between the home country and the host country (e.g., Pennings et al. 1994). We control for this by adding the variable *cultural distance* to the model. In measuring cultural distance, we follow Morosini et al. (1998), who define this variable as the degree to which the cultural norms of a country differ from those of

another country. We use a compound index based on Hofstede's (2001) national cultural scores for the following dimensions: Distance of power, refusal of uncertainty, masculinity/femininity and individualism.[3]

Results

A summary of the descriptive statistics and correlations for all variables is presented in Table 3. Given the dichotomous nature of the dependent variable, logit models are estimated. To control for heteroskedasticity, we apply a robust variance estimate. The results of the coefficient estimations and marginal effects are reported in Table 4 (Models 1 and 2). To test hypothesis 1b (Model 2), we distinguish acquisition experience according to its type. Therefore, we substitute the variable *international acquisition experience* with the dummy variables *developed market acquisition experience* and *developing market acquisition experience*.

In terms of the control variables, our findings indicate that state-owned emerging market firms are more likely to enter developed markets through unrelated acquisitions than privately owned firms ($p<0.01$; Table 4). State-owned firms might face greater risks and such firms might undertake projects that are in line with the government's agenda for national economic development, even though they are unrelated to the firm's core competencies (Cui and Jiang 2009). Our results also indicate that related acquisitions in developed markets are more likely in medium and high-tech manufacturing industries than in services or low-R&D intensive industries. The lack of significance for knowledge-intensive services may be the result of a lack of development of tertiary industries in emerging countries, which pushes EMNCs in medium and high-tech manufacturing industries to invest through related acquisitions more than EMNCs in service sectors.

In Model 1, international acquisition experience is positively related to the dependent variable, which indicates that this form of experience increases the likelihood of related acquisitions (relative to unrelated acquisitions). This result supports hypothesis 1a ($p<0.01$). The estimation used to test hypothesis 1b is presented in Model 2, Table 4. The coefficient of the variable *developed market acquisition experience* is significant and positively associated with the likelihood of related acquisitions ($p<0.1$), while previous acquisition experience in developing markets has no effect on the dependent variable. Therefore, hypothesis 1b is verified.

The variables *home-country market sophistication* and *home-country knowledge-based resources* show negative and significant coefficients ($p<0.05$) in both Models 1 and 2, although the effect of *home-country market sophistication* is slightly weaker ($p<0.1$) in Model 2. These results provide support for hypotheses 2a and 2b.

Discussion and Conclusions

Can the internationalisation process model be applied to EMNCs? We help to answer to this question by using the organisational learning perspective (March 1991; Barkema and Vermeulen 1998; Luo and Peng 1999) to study acquisitions undertaken by EMNCs in developed markets. We consider two important sources of organisational learning. First,

Table 3: Descriptive statistics

	Num	Mean	S.D.	Min.	Max.	1	2	3	4	5	6	7	8	9	10	11
1. Related acquisition	808	0.75	0.43	0.00	1.00											
2. International acquisition experience	808	0.46	0.58	0.00	2.49	0.11										
3. Developed market acquisition experience	808	0.28	0.45	0.00	1.00	0.09	0.78									
4. Developing market acquisition experience	808	0.34	0.47	0.00	1.00	0.06	0.80	0.38								
5. Home-country knowledge-based resources	808	0.00	1.00	−0.81	2.97	−0.11	−0.14	−0.11	−0.14							
6. Home-country market sophistication	808	0.00	1.00	−1.17	2.61	−0.05	0.17	0.06	0.15	0.00						
7. Acquirer industry diversification	808	0.44	0.49	0.00	1.79	−0.01	0.07	0.05	0.10	−0.09	−0.08					
8. State-owned acquirer	808	0.02	0.14	0.00	1.00	−0.08	−0.02	−0.01	−0.03	−0.17	0.03	0.05				
9. Target in medium-tech manufacturing	808	0.23	0.42	0.00	1.00	0.09	0.06	0.02	0.04	0.01	−0.17	0.09	0.00			
10. Target in high-tech manufacturing	808	0.19	0.40	0.00	1.00	0.06	0.04	0.04	0.04	−0.04	0.12	0.11	0.04	−0.27		
11. Target in knowledge-intensive services	808	0.33	0.47	0.00	1.00	−0.05	−0.04	0.00	−0.03	0.17	0.15	−0.19	−0.05	−0.38	−0.34	
12. Cultural distance	808	4.20	0.24	2.59	4.72	−0.06	−0.05	−0.10	0.02	−0.50	−0.12	0.07	0.12	0.03	0.00	−0.15

Table 4: Determinants of south-north related acquisitions

	Model 1						*Model 2*					
	Coefficients			Marginal effects			Coefficients			Marginal effects		
Constant	0.88	(1.78)					0.81	(1.76)				
International acquisition experience	0.44	(0.15)	***	0.08	(0.03)	***						
Developed market acquisition experience							0.39	(0.21)	*	0.07	(0.03)	*
Developing market acquisition experience							0.13	(0.21)		0.02	(0.04)	
Home-country knowledge-based resources	−0.18	(0.09)	**	−0.03	(0.02)	**	−0.19	(0.09)	**	−0.03	(0.02)	**
Home-country market sophistication	−0.17	(0.09)	**	−0.03	(0.02)	**	−0.15	(0.09)	*	−0.03	(0.02)	*
Acquirer industry diversification	−0.12	(0.17)		−0.02	(0.03)		−0.12	(0.18)		−0.02	(0.03)	
State-owned acquirer	−0.91	(0.50)	*	−0.20	(0.12)		−0.89	(0.51)	*	−0.19	(0.12)	
Target in medium-tech manufacturing	0.71	(0.26)	***	0.11	(0.04)	***	0.72	(0.26)	***	0.12	(0.04)	***
Target in high-tech manufacturing	0.56	(0.26)	**	0.09	(0.04)	**	0.56	(0.26)	**	0.09	(0.04)	**
Target in knowledge-intensive services	−0.03	(0.22)		−0.005	(0.04)		−0.03	(0.22)		−0.005	(0.04)	
Cultural distance	−0.02	(0.42)		−0.004	(0.08)		0.01	(0.42)		0.001	(0.007)	
Log-pseudolikelihood		−432.75			−432.75			−437.02			−434.02	
Wald χ^2		34.16***			34.16***			31.50***			31.80***	
McFadden's adjusted pseudo-R^2		0.04			0.04			0.04			0.04	
N		808			808			808			808	

Logit regressions. Robust standard errors in brackets, corrected for heteroscedasticity

*p<0.10; **p<0.05; ***p<0.01 (two-tailed tests applied)

we take the firm's international acquisition experience into account, as the resource-based view suggests that such experience matters (Cohen and Levinthal 1990; Luo and Peng 1999). Second, given the ongoing debate about the role of country-specific characteristics in the international investments of EMNCs (Mathews 2006; Rugman and Li 2007; Kalotay 2008; Ramamurti 2009), we analyse how the home country environment can affect firms' learning behaviours and, consequently, their cross-border acquisitions.

Overall, our findings indicate that international acquisition experience positively affects the likelihood of exploitative (related) acquisitions by EMNCs, while home-country endowments favour explorative moves. In line with the internationalisation process model, we find that when expanding in developed markets through related acquisitions, EMNCs benefit from knowledge obtained from multinational diversity and acquisition experience. This confirms earlier research that predicts incremental expansion patterns (e.g., Johanson and Vahlne 1977; Barkema and Vermeulen 1998; Barkema and Drogendijk 2007).

Furthermore, potential absorptive capacity (Zahra and George 2002) accumulated through previous foreign acquisitions is location bound (Hitt et al. 2005). Essentially, emerging market firms are more likely to undertake related investments in developed markets if they are already somewhat familiar with developed market cultures and business practices. London and Hart (2004) suggest that western MNCs are likely to use different strategies and a mix of capabilities when entering emerging economies. This is partially explained by the ways in which the social and economic patterns of developed countries differ from those of developing countries. For instance, the informal economy and social boundaries in emerging markets often dominate over the formal economy (de Soto 2000). Accordingly, researchers have highlighted how MNCs can operate in markets characterised by more turbulent environments by learning from previous FDI experience in the same country or in other countries in the same cultural block (Luo and Peng 1999; Hitt et al. 2000; Barkema and Drogendijk 2007). Our results show that similar conditions hold for emerging market firms investing in developed countries. Related, incremental acquisitions are more likely to occur when the acquiring emerging market firm has had an opportunity to become familiar with social and business infrastructures—such as distribution channels or communication techniques—found in developed countries. Conversely, experiential learning about developing markets appears to be less valuable in enhancing acquisitions that are exploitative in character. Accordingly, our findings suggest that the view of the Uppsala school of international expansion, which suggests that subsequent foreign investments are more likely to occur in a proximate culture (e.g., Johanson and Vahlne 1977; Barkema and Drogendijk 2007), can also be applied to south-north acquisitions.

Internationalisation processes have typically been studied from an organisational learning perspective that focuses on the role played by firm experience. However, the recent surge in FDI flows from emerging markets creates an opportunity to observe how other factors, such as home country knowledge-based resources and market sophistication, can affect firms' learning behaviours and their internationalisation processes. Our results show that firms located in home countries that are at a disadvantage in terms of market sophistication and knowledge-based resources are more likely to undertake incremental, related acquisitions. The greater the lack of adequately trained scientists, tech-

nological competencies and market-based institutions at home, the lower the knowledge and absorptive capacity of the local firms. In this respect, the gap between the market leaders and emerging market firms translates into a foreign incremental strategy designed to pursue the refinement of the firms' existing knowledge domains with limited risk (i.e., related acquisitions). Conversely, higher levels of home-country resources and market factors are positively correlated with the likelihood of unrelated acquisitions. In these environments, local firms are exposed to diverse learning opportunities that enhance their knowledge base and absorptive capacity and, thus, their probability of acquiring firms in unrelated businesses. In other words, our results offer preliminary evidence that improvements in the domestic environment, which may be the result of home government policies and investments, may drive explorative learning that favours unrelated acquisitions by EMNCs in developed markets.

Finally, our results provide some support for Dunning's (2006) view that that firm-specific advantages matter when emerging market firms seek new resources and knowledge in developed markets. International experience is a firm-specific capability that allows a company to secure its success abroad (Bartlett and Ghoshal 2000; Thomas et al. 2007). Dunning (2006) argues that although emerging market firms are likely to pursue investments to access strategic resources more aggressively, they must still possess some unique capabilities or favoured access to markets. Within the eclectic paradigm, the specific knowledge and experience that EMNCs have developed through their previous experiences in international expansion can be viewed as an ownership-specific advantage (Dunning 1992; Luo and Peng 1999).

Our study is affected by several limitations. First, given the limits of the data, we cannot extend the experience measures to capture other forms of learning, such as those arising from entry modes other than acquisitions (e.g., licensing, joint ventures or alliances). Second, explorative and exploitative acquisitions are discerned using acquirer-target sectoral relatedness, with related acquisitions being viewed as a proxy for exploitative strategies and unrelated acquisitions assumed to be explorative in nature. While this delineation is supported by the extant literature, the association is clearly imperfect. Third, our measures of country characteristics are subject to some limitations, as we only consider market and knowledge-based advantages. Other country-specific resources (e.g., natural resources) may be important in explaining firms' learning behaviours and their acquisitions in developed markets. Fourth, it would be useful to introduce variables that measure the effective resources of EMNCs, such as their tangible, intangible and financial assets. Indeed, the inclusion of these variables would allow for better identification of the firm-specific advantages of EMNCs, and their roles in driving related and unrelated acquisitions. Fifth, we focus our investigation on south-north acquisitions, which are a growing phenomenon (Cantwell and Barnard 2008; Sauvant 2008; Duysters et al. 2009; UNCTAD 2011). However, EMNCs also use greenfield investments and joint ventures to enter developed markets (albeit less often than MNCs from developed markets). Future research could extend the validity of our findings to a broader spectrum of entry modes. Finally, while our paper investigates the drivers of south-north acquisitions, it does not consider the implications of learning and country characteristics in relation to the success of those acquisitions. In this respect, we do not link a south-north acquisition undertaken by an emerging market

firm to any performance measure (e.g., survival, technological performance, financial performance). This topic may be a subject for future research.

Endnotes

1 In using the US input/output tables for a sample that does not only include transactions within the US, we implicitly assume that sectoral ties are not country-specific and that they reflect fundamental characteristics of the production technology. This assumption is common in empirical studies of international trade (such as Bowen et al. 1987).

2 We consider the OECD countries and the transition Eastern European economies (with the exception of Russia) to be advanced countries. These correspond to the host countries in our sample. Knowledge arising from previous acquisitions in these countries is likely to be more useful for present and future acquisitions in these countries than knowledge arising from acquisitions made in other (developing) economies. Previous investments undertaken by EMNCs in Turkey, South Korea and Mexico, which now belong to the OECD, have been excluded from the OECD group and included in the developing country group, as these countries share characteristics of developing economies during most of the period considered in our sample.

3 Hofstede's (2001) national cultural scores are available on Hofstede's website (http://www.geert-hofstede.com).

The index is computed according to the to the following formula: $CD_{jk} = \sqrt{\sum_{i=1}^{4} (I_{ij} - I_{ik})^2}$, where CD_{jk} is the cultural difference between country j and country k, I_{ij} is the Hofstede's score for each of the four ith cultural dimensions of the jth country, and I_{ik} is the Hofstede's score for each of the four ith cultural dimensions of the kth country. As a robustness check, we also compute the Kogut and Singh (1988) formula, which takes the variance of the index in each ith dimension into account. The correlation between the two formulas is higher than 90% and the two indexes yield the same results.

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