EDITED BY S. RAGHUNATH
AND ELIZABETH L. ROSE

INTERNATIONAL BUSINESS STRATEGY

Perspectives on Implementation in Emerging Markets

International Business Strategy

S. Raghunath • Elizabeth L. Rose
Editors

International Business Strategy

Perspectives on Implementation in Emerging Markets

palgrave
macmillan

Editors
S. Raghunath
Indian Institute of Management Bangalore
Bangalore, India

Elizabeth L. Rose
University of Otago, Dunedin, New Zealand

Aalto University, Helsinki, Finland

Indian Institute of Management Udaipur,
Udaipur, India

ISBN 978-1-137-54466-7 ISBN 978-1-137-54468-1 (eBook)
DOI 10.1057/978-1-137-54468-1

Library of Congress Control Number: 2016959563

Printed on acid-free paper

This Palgrave Macmillan imprint is published by Springer Nature
The registered company is Macmillan Publishers Ltd. London
The registered company address is: The Campus, 4 Crinan Street, London, N1 9XW, United Kingdom

Acknowledgments

We would like to express our appreciation to some friends and colleagues who have played key roles in making this volume a reality. The Academy of International Business (AIB), through its Executive Board and its Secretariat, has provided generous and much-appreciated support to the AIB-India Chapter, which is chaired by S. Raghunath. We offer our deep thanks to the members of the past several Executive Boards and to the AIB Secretariat: Tunga Kiyak, Tomas Hult, Kathy Kiessling, and Irem Kiyak.

The chapters in this volume have been drawn from four AIB-India Chapter events. We are grateful to the colleagues who organized and hosted these conferences and paper development workshops:

– 2013 conference at IIM Bangalore: S. Raghunath (Chair) and Pankaj Chandra (Director)
– 2014 conference at IIM Udaipur: Thomas Joseph (Chair) and Janat Shah (Director)
– 2014 PDW at IIM Bangalore: S. Raghunath (Chair) and Sushil Vachani (Director)
– 2015 PDW at Symbiosis International University: Sophia S. Gaikwad and Pratima Sheorey (Co-chairs), Rajani R. Gupte (Vice Chancellor), and Vidya Yeravdekar (Principal Director)

The AIB-India chapter has a strong focus on providing opportunities for its members to develop their research, with support from scholars from far and wide. We acknowledge, with warm appreciation, the contributions of research mentors at these four events: Snehal Awate, Suresh Bhagavatula, Charles Dhanaraj, Rishikesha Krishnan, Sumit Kundu, Ram Mudambi, Torben Pedersen, S. Raghunath, Elizabeth L. Rose, and Sai Yayavaram.

Much of the behind-the-scenes effort associated with bringing this volume to fruition has fallen to Shankari Chidambaram, Supriya Dey, and Sudha Gurunathan, with support from Kamla Venkatesh, Akhila Surendran, and Tanuja Yelale. Thank you all so much for all of your work.

Thanks, too, go to Ron Morrison and Usha Raghunath, who have certainly heard considerably more about this book than is optimal (at least from their perspectives!).

We are, of course, extremely appreciative to all of the authors whose work is included in this volume. Warm thanks are due to each of you, for your responsiveness and your trust.

Last—and by absolutely no means least—we are deeply grateful to Maddie Holder and Liz Barlow at Palgrave Macmillan and to Gayathri Senguttuvan at SPi Technologies. This volume would not have happened without your patience, persistence, and guidance.

Contents

Notes on Contributors

Gaurav Agrawal is an associate professor at the ABV (IIITM). He obtained his Masters and Ph.D. from Bundelkhand University, Jhansi, India. He has written 15 research papers and has given talks at various national and international conferences.

Raji Ajwani-Ramchandani is a researcher based in Pune, India. She has more than 18 years of work experience in India and the U.S. (across various sectors such as banking, information technology, media, and entertainment). Her research interests include sustainability, base of the pyramid issues, gender and empowerment, and banking.

Byram Anand is an assistant professor at Pondicherry University, Karaikal, India. His areas of research are marketing of services, international business, financial inclusion, and healthcare marketing.

Kshitij Awasthi is a doctoral candidate in the strategy area at the Indian Institute of Management Bangalore, India. His primary research interests are in corporate political strategies, corporate governance, and international business. His work has been published in peer-reviewed journals, and his papers have been accepted at top international conferences including AOM, AIB, and SMS.

Krishna Kumar Balaraman is a research scholar at the Indian Institute of Technology Madras, in the area of strategic management. He has over two decades of leadership experience in industry and has been a visiting faculty member at Indian Institute of Management Shillong. His research interests include strategic alliances, corporate foresight, microfoundations of organizations, international business, and brand management.

Shailen Kumar Dalbehera is a doctoral student at the Indian Institute of Management Bangalore. His dissertation is entitled "Internalization of IJVs and Institutions". Prior to entering the doctoral program, he worked at Infosys Technologies Limited as a software engineer. His research interests include institutions, influence rents, subnational regions, joint ventures, and mergers and acquisitions.

Rupanwita Dash is a doctoral student at the Indian Institute of Management Bangalore (IIMB). Her dissertation focuses on multimarket competition in Indian pharmaceutical industry. Prior to joining IIMB, she worked as a senior researcher with IFMR Lead on evidence for policy design in environment sustainability.

Preeti Flora holds a Bachelors degree (Hons.) in Engineering, Masters in Business Administration in Finance, with distinction, and a Ph.D. in International Business from ABV-IIITM. Her major research interests include foreign direct investment in emerging economies and econometrics. So far, seven of her research/review papers have been published, and she given talks at prestigious management institutes in India including IIMs and IITs.

Baba Gnanakumar has 23 years of teaching experience. He has presented 83 research papers, and 35 of his research articles have been published. He has received two best research paper awards in international conferences organized by the Indian Institute of Management, and has guided 13 research scholars. He is a Professor in Commerce at the Sri Krishna Arts and Science College, Coimbatore, specializing in entrepreneurship.

Deepak Gupta is a professor at the Amrita School of Business. His qualifications include: B.Tech. (IIT Delhi), PGDM (IIM Calcutta), M.A. in Economics (UC Berkeley), M.S. in Marketing (UC Berkeley), and Ph.D. (UC Berkeley). His research interests include globalization, innovation, and consumer behavior.

Thomas Joseph is Associate Professor in the area of Business Policy and Strategy at the Indian Institute of Management Udaipur. His areas of research, teaching, and consulting include strategy formulation, strategy execution, performance management, and international business strategy. He is an electrical engineer and also a Fellow (Ph.D.) of Indian Institute of Management Bangalore in the area of Corporate Strategy and Policy.

Venkatesh Kambla is pursuing his Doctorate in Finance and Accounting from the Indian Institute of Management, Bangalore. Prior to joining IIMB, he was worked for Indian Overseas Bank for 12 years. His research interests include corporate spin-offs, banking, monetary policy, international finance, and international business and entrepreneurship.

Ankur Lal is a research scholar at the Amity International Business School, Amity University. With an academic background in psychology, her research interests focus on the human aspects of management. Her PhD research is in the area of performance management systems and their relationship with job satisfaction and managerial effectiveness. She holds a post-graduate diploma in training and development, and has rich experience of working as a consultant psychologist to organizations, schools, non-governmental organizations, and hospitals.

Shobhana Madhavan is pursuing her Ph.D. in International Business at Deakin University, Australia. Her qualifications include the following: B.E (Delhi College of Engineering), PGDM (IIM-Ahmedabad), and M.P.S (Cornell University). Before joining the Amrita School of Business, she worked for over a decade as an international development consultant in Southeast Asia and Madagascar.

Denny Meyer is Associate Professor of Statistics at the Swinburne University of Technology. She has co-authored two books and upward of 100 of her articles have been published in a variety of refereed journals and books. She is an applied statistician, working in areas such as management, mental health, and sport.

Siddharth Mohapatra is a learner and teacher in the field of organizational behavior and human resource management.

Kajari Mukherjee is an associate professor at the Indian Institute of Management Indore. Her areas of research include organization design using the paradigm of complexity theory, issues in human resource management, and corporate social responsibility in emerging countries. She has authored books, peer reviewed journal articles, and cases.

Krishnaveni Muthiah is a professor at PSG Institute of Management, Coimbatore. Her text books on “Logistics Management” and “International Relations” are read with avid interest. Her work has been published in the international journals of *Asia Pacific Journal of Marketing and Logistics* and *Management Research Review*.

Vishnuprasad Nagadevara is the Dean at the Woxsen School of Business, India, having previously held appointments at Iowa State University and the Indian Institute of Management Bangalore. He obtained his doctorate in Economics and Operations Research from Iowa State University. His current interests are data mining techniques and applications, application of operations research techniques, project management, project evaluation, and information technology applications.

Murali Patibandla is Professor of Corporate Strategy at the Indian Institute of Management Bangalore. He obtained his doctoral degree in International Economics from Jawaharlal Nehru University and was a Fulbright postdoctoral fellow at the University of California, Berkeley. He is listed among the top authors in Law and Economics by Academic Search International.

S. Raghunath is Professor of Corporate Strategy and Policy at the Indian Institute of Management Bangalore, India. He was a visiting scholar at the Graduate School of Business of Stanford University in 1990–1991. He is involved in teaching, consulting, and research activities related to the growth strategies of information technology companies in India, the strategic development of MNC subsidiaries in India, and strategic outsourcing.

Satyanarayana Rentala is a doctoral research scholar at Pondicherry University, Karaikal, India. His areas of research interest are international business, financial inclusion, intellectual capital, business ethics, and brand management.

Elizabeth L. Rose is Professor of International Business and Associate Dean (International) at the University of Otago in New Zealand. She is also a visiting professor at Aalto University (Finland) and Adjunct Professor at the Indian Institute of Management Udaipur. She is a Fellow, and former Vice President of the Academy of International Business, and has held elected positions in the Academy of Management and the Strategic Management Society. Her core research deals with various aspects of internationalization, especially for small and service-sector firms.

Arun Sacher is a seasoned HR practitioner and Professor of Strategic HRM and OB, with more than 27 years of experience in OD, SHRM, and cross-cultural management. An advisor, consultant, and trainer to many MNEs, industries, institutions, and universities, he has been a visiting professor at Anglia Ruskin University, New York University, University of Leeds, and Amity University. He is the author of *Organisation Climate and Managerial Effectiveness*.

Sreevas Sahasranamam earned his doctorate in Strategic Management at the Indian Institute of Management Kozhikode and is currently a post-doctoral researcher at the University of Liverpool, U.K. His research interests include entrepreneurship, corporate social responsibility, and innovation in emerging markets. He is a recipient of the Strategic Management Society's Strategic Research Foundation Dissertation Fellow Program for the period 2015–2016.

B.R. Santosh is a lecturer at Al Musanna College of Technology, Muscat, Oman. He has over 12 years of teaching experience, having obtained his MBA from Manipal Academy of Higher Education and his Ph.D. from Anna University, Chennai. He has authored two text books, and his articles have found their place in prominent international- and national-level journals.

Christopher Selvarajah is Professor of International Business at the Faculty of Business and Law at Swinburne University of Technology in Melbourne. His general interest is in management and in international business, with a focus on leadership and cultural diversity studies, and his work has been published extensively in these fields.

Majid Shaban is a doctoral research scholar at Pondicherry University, Karaikal (India). His research interest areas are intellectual capital, banking and financial services, and international business.

Sandeep Sivakumar is a doctoral student in the Strategic Management area at the Indian Institute of Management Kozhikode. His research interests include internationalization and corporate governance of emerging market firms. He has over five years of experience in project management and consulting for government projects.

Pavan Soni is an innovation evangelist by profession and a teacher by passion. He has consulted with leading organizations on innovation and creativity. He is a Gold Medalist from MBM Engineering College Jodhpur, and PGDIE from NITIE Mumbai. He is pursuing his Ph.D. from the Indian Institute of Management Bangalore in Innovation Management.

R. Srinivasan is Professor of Corporate Strategy at the Indian Institute of Management Bangalore. He received his doctoral degree (Fellow Program in Management) from the Indian Institute of Management Ahmedabad. His work has been published as books, papers, and cases on Indian organizations, platform business models, rapid growth, strategy, and knowledge management.

Pratima Verma is Professor at Alliance University, and passionate about understanding human behavior, trying to learn it through research in OB & HR.

List of Figures

List of Tables

1

International Business in the Context of Emerging Markets

S. Raghunath and Elizabeth L. Rose

Introduction

While there is little agreement about the definition of "emerging markets", and which nations are included in this category, there is no doubt that emerging economies—however they are defined—are, collectively, playing an increasingly important role in the global economy. International trade had long been driven primarily by corporations based in developed markets, but the past two decades have witnessed substantial structural changes. Emerging markets are no longer solely

S. Raghunath
Indian Institute of Management Bangalore, Bangalore, India
e-mail: srnathiimb@gmail.com

E.L. Rose (✉)
University of Otago, Dunedin, New Zealand

Aalto University, Helsinki, Finland

Indian Institute of Management Udaipur, Udaipur, India
e-mail: elizabeth.rose@otago.ac.nz

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_1

"recipients" of international economic activity, but are now active participants in worldwide commerce. Flows of high-value trade and foreign direct investment (FDI), in both goods and services, are no longer primarily north–north (i.e., between developed economies) or north–south (i.e., from developed to developing countries), but are now increasingly south–south and south–north. As multinational enterprises (MNEs) from developed economies continue to trade with, and invest in, developing and emerging markets, in order to gain access to materials and lower-cost factors of production, they are also tapping into the emerging markets' large customer bases and their burgeoning spending power. At the same time, emerging-market MNEs (EMNEs) are expanding their global reach, in terms of both trade and FDI.

As shown in Fig. 1.1, the values of exports from emerging/developing and developed economies are currently quite close; in 2015, emerging and developed economies accounted for 44.6 % and 52.2 %, respectively,

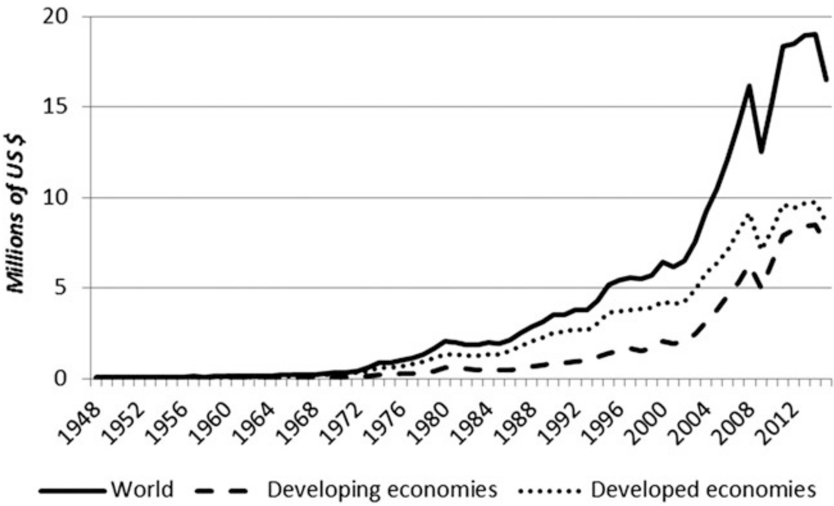


Fig. 1.1 Exports from developing and developed economies
Data compiled from UNCTAD (2016)
Note that UNCTAD refers to "developing economies", "transition economies", and "least-developed countries". We use the UNCTAD "developing" classification to represent emerging markets.

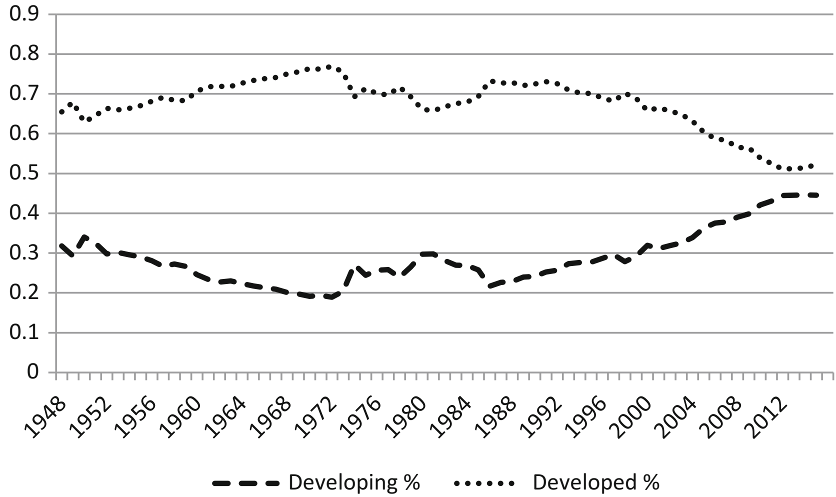


Fig. 1.2 Proportions of world exports from developing and developed economies
Data compiled from UNCTAD (2016)

of the world's exports (UNCTAD 2016). This near-parity is a recent phenomenon, as illustrated in Fig. 1.2.

Of course, the nature of the export patterns varies considerably within emerging markets. A comparison of the two key emerging economies of India and China provides a clear example. As illustrated in Figs. 1.3 and 1.4, China's exports comprise primarily tangible goods, with the value of service exports only 9.2 % that of goods in 2015. In stark contrast, the export of services plays a much more important role for India; the value of India's 2015 exports of services represented nearly half (48.4 %) of its total exports of goods (UNCTAD 2016).

The emerging market story also involves FDI. Emerging economies have long been recipients of inward FDI. Table 1.1 displays data pertaining to inward FDI stocks in key developed and emerging markets. Inward FDI to emerging markets remains strong; 55.5 % of the world's inward FDI in 2014 was directed at these markets (UNCTAD 2016). In 2014, China, Brazil, and India were all among the 10 highest recipients of FDI (UNCTAD 2015).

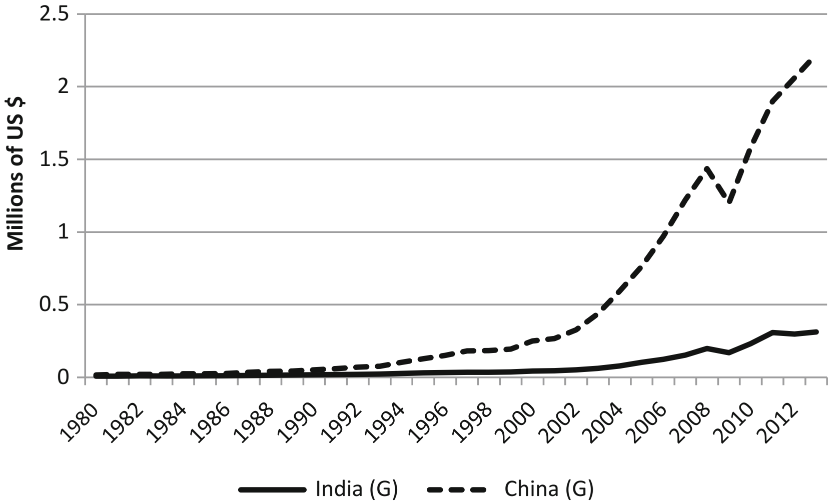


Fig. 1.3 Exports of goods from India and China
Data compiled from UNCTAD (2016)

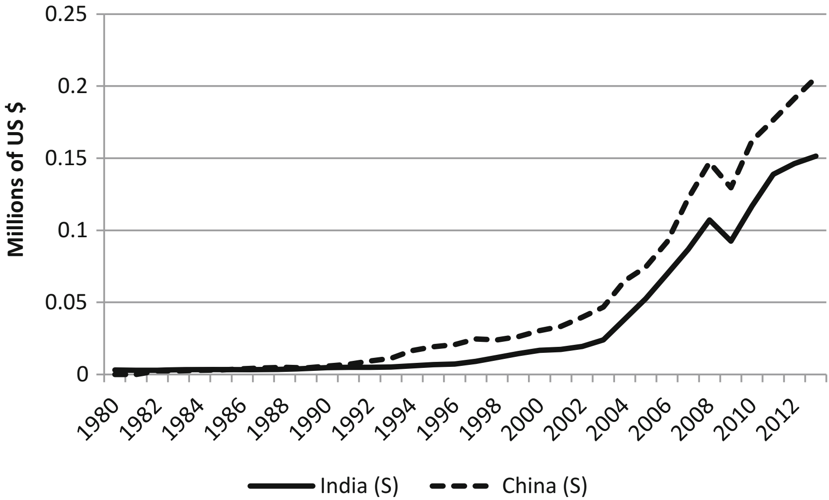


Fig. 1.4 Exports of services from India and China
Data compiled from UNCTAD (2016)

Table 1.1 Inward FDI stocks[a]

Region/country	1980	1990	2000	2010	2014
Europe[b]	33.6 %	42.4 %	31.4 %	40.3 %	35.1 %
UK	9.0 %	9.3 %	6.4 %	5.6 %	6.8 %
France	4.5 %	4.7 %	2.6 %	3.2 %	3.0 %
Germany	5.2 %	10.3 %	3.8 %	3.7 %	3.0 %
Netherlands	3.5 %	3.3 %	3.4 %	3.3 %	2.7 %
USA	11.8 %	24.6 %	38.6 %	17. 5%	22.0 %
Japan	0.5 %	0.4 %	0.7 %	1.1 %	0.7 %
Emerging markets[c]	42.0 %	23.2 %	23.2 %	31.1 %	33.7 %
Brazil	2.5 %	1.7 %	1.7 %	3.5 %	3.1 %
Russia	0.0 %	0.0 %	0.4 %	2.5 %	1.5 %
India	0.1 %	0.1 %	0.2 %	1.0 %	1.0 %
China	0.2 %	0.9 %	2.7 %	3.0 %	4.4 %
South Africa	2.3 %	0.4 %	0.6 %	0.9 %	0.6 %
World IFDI stock[d]	7011.6	2197.8	7203.8	19607.4	24626.5

[a] Compiled from UNCTAD (2016)
[b] This represents what UNCTAD refers to as "Developed Europe"
[c] This represents what UNCTAD refers to as "Developing economies"
[d] Billions of US $

In the current global economy, emerging markets are not the only recipients of FDI. Table 1.2 provides some historical perspective on outward FDI; while outward FDI originated almost exclusively from Europe early in the 20th century, emerging markets were the source of 19.6 % of the accumulated FDI in 2014 (Ramamurti 2012; UNCTAD 2016). This figure is clearly set to rise. FDI flows from emerging markets accounted for 34.6 % of the worldwide outward FDI in 2014, with China and Russia the third- and sixth-largest source countries, respectively (UNCTAD 2015).

There is both academic and practical value, and interest, in developing a deeper understanding of how business takes place in emerging markets. In many regards, the traditional frameworks used in the international business literature fail to fully capture this phenomenon. The present volume aims to provide insights into emerging-market business environments, offering the perspectives of researchers who are deeply embedded in one key emerging market: India. The 19 chapters are drawn from papers presented at conferences and paper development workshops

Table 1.2 Outward FDI stocks[a]

Region/country	1914	1969	1980	1990	2000	2010	2014
Europe[b]	93.0%	43.2%	42.2%	41.3%	31.0%	38.7%	35.1%
U.K.	50.0%	16.2%	14.4%	10.2%	12.7%	8.0%	6.4%
France	43.0%	n.a.	4.5%	5.3%	5.0%	5.7%	5.2%
Germany		n.a.	7.7%	13.7%	7.4%	7.2%	6.4%
Netherlands		n.a.	9.5%	4.9%	4.2%	4.9%	4.0%
U.S.A	6.0%	55.0%	38.5%	32.5%	36.9%	23.6%	25.7%
Japan	0.0%	1.3%	3.5%	8.9%	3.8%	4.1%	4.8%
Emerging markets[c]	0.0%	0.0%	12.7%	6.2%	10.2%	14.9%	19.6%
Brazil			6.9%	1.8%	0.7%	0.9%	1.3%
Russia			0.0%	0.0%	0.3%	1.8%	1.8%
India			0.0%	0.0%	0.0%	0.5%	0.5%
China			0.0%	0.2%	0.4%	1.6%	3.0%
South Africa			1.0%	0.7%	0.4%	0.4%	0.5%
World OFDI stock[d]	n.a.	n.a.	559.0	2,253.9	7,298.2	20,414.1	24,602.8

[a] Data for 1914 and 1969 are from Ramamurti (2012); data for other years are from UNCTAD (2016).
[b] This represents what UNCTAD refers to as "Developed Europe".
[c] This represents what UNCTAD refers to as "Developing economies".
[d] Billions of US $

organized by the India Chapter of the Academy of International Business (AIB-India). Reflecting the complex nature of India itself, the chapters employ a variety of theoretical lenses to shed light on a wide range of issues encountered by businesses operating in emerging markets, from some of the world's largest corporations to small, entrepreneurial firms.

The 19 chapters presented in this book attempt to generate a holistic exposure to the work of the scholars from a range of different starting points, building on institutionally informed perspectives on emerging markets. The volume presents a multidisciplinary research agenda, encompassing contributions from a range of functional areas associated with the broad field of international business. The chapters represent the outcomes of research by scholars with deep-seated understanding of how institutions affect firm-level outcomes, both at home and globally.

The book is organized into six sections. The first two pertain to key aspects of strategy among emerging-market firms. The chapters in the third section deal with exporting and entrepreneurship in the Indian context. This is followed by three chapters that address aspects of finance and technology. The fifth section has a more micro focus, with chapters considering some of the challenging aspects of managing people in emerging-market firms. The final section offers insights into an issue of great importance to Indian corporations—providing opportunities for the economically disenfranchised.

International Strategy in the Emerging-Market Context: The Big Picture

These first three chapters are literature-driven and conceptual studies that address distinct aspects of governance and strategic management in the emerging-market context.

In "Taking Stock of the Principal–Principal Agency Perspective: A Review and the Way Ahead" (Chap. 2), Kshitij Awasthi discusses the limitations of traditional agency theory in the context of corporate governance in emerging-market firms, in light of the specificity of the institutional environment in which they operate, relative to those of developed economies. These institutional distinctions mean that potential conflicts of interest between controlling and minority shareholders ("principal-principal agency") are more salient than the traditional focus on principal-agent conflict. Awasthi provides a comprehensive review of the literature on this issue, along with suggestions for future research.

The theme of corporate governance continues in Chap. 3, "Internationalization of Emerging-Market Firms: The Contingent Role of Board Capability", by Sandeep Sivakumar, Sreevas Sahasranamam, and Elizabeth L. Rose. This conceptual work builds on a resource-based perspective to argue that specific attributes of members of the board of directors are critical for international performance among EMNEs. In particular, a new measure of board capability is proposed, which includes aspects of board members' skills and backgrounds, and the extent to which the board members interact with each other in the conduct of their governance of the firm. Sivakumar, Sahasranamam, and Rose argue that board interaction is especially critical among EMNEs, offering the potential to increase the impact of internationalization on firm performance.

The last chapter in this section offers an overview of the extant work on how firms compete with each other in multiple locations around the world, and how these repeated interactions affect strategic options. In "Research in Multipoint Competition: What Do We Know and Where Are We Headed?" (Chap. 4), Rupanwita Dash sheds light on what we understand, and what we do not, with respect to the increasingly important issue—given rapid expansion of foreign operations—of how the firm's international strategy is influenced by this under-researched aspect of strategic complexity, which can be especially challenging for EMNEs.

Strategic Changes in Organizational Forms

The next section comprises four chapters, each of which addresses emerging-market firms that are dealing with strategy-driven changes in their organizational forms: joint ventures, strategic alliances, acquisitions, and the spinning off of subsidiaries.

In "Internalization of IJVs and Institutions" (Chap. 5), Shailen Kumar Dalbehera, S. Raghunath, R. Srinivasan, Murali Patibandla, and V. Nagadevara employ an institutional perspective to address the issue of which parent in an international joint venture (IJV) "wins", in terms of gaining ownership of the IJV when it is terminated. In this empirical paper, the authors find evidence that, upon termination, India-based IJVs are more likely to be internalized by the Indian parent when the IJV had been operating in a highly regulated industry. This finding offers interesting potential for further study.

Another type of change in organizational form, the spinning off of a subsidiary, is the situation addressed by Venkatesh Kambla in "Do Spin-Offs Really Create Value? Evidence from India" (Chap. 6). In this empirical study of spin-offs from Indian parent firms, Venkatesh finds evidence that this strategy offers, on average, long-term financial benefits for both the parent and the newly created (spun-off) firm. It is interesting to note that this finding is consistent with those of comparable studies of spin-offs in Japan and the USA, despite the very different institutional environments, systems of corporate governance, and motivations driving the use of the spin-off strategy in these three national contexts.

Acquisition is the change in organizational form considered in Chap. 7. In "The Influence of Liabilities of Origin on EMNE Cross-Border Acquisition Completion", Shobhana Madhavan and Deepak Gupta undertake an empirical study of how the liability of origin—with respect to perceptions of capability and credibility—is related to the probability that Indian MNEs are able to complete international acquisitions. Madhavan and Gupta find that acquisition experience matters, but that depth of experience (i.e., a larger number of successful acquisitions) is more important than breadth (i.e., acquisitions in a larger number of countries). These findings offer real potential for further work in this under-studied area of inquiry.

Thomas Joseph and S. Raghunath focus on cross-border strategic alliances in "International Strategic Alliances for Innovation in the Indian Biotechnology Industry" (Chap. 8). Specifically, the focus is on small firms that are seeking to learn from alliance partners, with the intent of enhancing their own innovative capabilities. Joseph and Raghunath develop two frameworks, based on firm-specific factors that may improve the firm's ability to internalize new skills and capabilities, and then recombine them to generate innovation.

Entrepreneurship and Exporting

The third section consists of three chapters that deal with issues of exporting and entrepreneurship among firms in India.

Rapidly internationalizing firms are the focus of "Emerging-Market Born Globals: The Influence of Product-Related Factors on Internationalization Mode in the Indian Apparel Industry" (Chap. 9), by S. Raghunath and Krishna Kumar Balaraman. Building on the knowledge-based internationalization process perspective, Raghunath and Balaraman find that the seven case firms in the study have maintained their use of low-commitment entry modes (e.g., producing in India and exporting), and identify that the nature of the firms' products are related to the choice of entry mode and the nature (and extent) of their acquisition of knowledge pertaining to their international customers.

Pavan Soni also uses a qualitative approach, studying innovation among entrepreneurs that operate in the informal economy, which is generally associated with low pay, weak social protection, exploitation, and few opportunities for moving out of poverty. Informal economies play important roles in emerging markets, and India is widely viewed as having the world's largest informal economy. In "Innovation and Entrepreneurship in the Informal Economy: Insights from the Ground Zero" (Chap. 10), Soni aims to develop a deeper understanding of why these entrepreneurs have opted to work within the informal economy, the processes by which they innovate in their businesses, and the manner in which they interact with the formal economy.

In Chap. 11, Satyanarayana Rentala, Byram Anand, and Majid Shaban focus on the export performance, considering larger firms in two key knowledge- and technology-intensive Indian industries. Their study, entitled "Determinants of Export Performance: An Empirical Analysis of the Indian Pharmaceutical and Automobile Industries", analyzes the determinants of export sales, providing deep insights into the international activities undertaken by firms in two industries that generate considerable export income for India.

Finance and Technology

The three chapters in this section address some of the quite technical aspects of international business in the context of emerging markets.

In "FDI and Economic Growth Nexus for the Largest FDI Recipients in Asian Emerging Economies: A Panel Co-integration Analysis" (Chap. 12), Preeti Flora and Gaurav Agrawal report on a macro-level econometric analysis that seeks to address the important—and unresolved—question of whether or not inward FDI is associated with economic growth in five developing and emerging nations in Asia: China, India, Malaysia, Thailand, and Singapore. Using time-series analysis, Flora and Agrawal identify differences in the nature of the relationship between inward FDI and economic performance among these five countries.

The connectedness of global financial markets is a key attribute of today's business environment, and has the potential to exert particularly strong influence on emerging markets. This is the context explored in "Global Financial Markets Integration: A Comparative Study between Developed and Emerging Economies" (Chap. 13). In this study, Gaurav Agrawal reports on macro-level econometric analysis of the degrees to which stock market indices tend to vary similarly through time, with a strong emphasis on the effects of the global financial crisis.

Chapter 14 reports on a qualitative investigation into the complex world of patents and the protection of intellectual property, especially in the context of emerging markets that tend to have weaker institutions in this respect. In "Vicious Cross-licensing Strategy for Technology Spread: Case Study of Samsung Electronics", Baba Gnanakumar discusses strategies that technology-generating firms can employ, in order to limit their exposure, with respect to protecting their investments in innovative activities.

Managing People in Emerging-Market Firms

This section represents a shift from macro issues to people-related ones, with chapters addressing topics that include employee engagement, training, and commitment, along with leadership in different cultural contexts.

In "Repatriates' Organizational Commitment in the Indian Information Technology (IT) Environment" (Chap. 15), Krishnaveni Muthiah and B.R. Santosh address a problem of practical importance to MNEs: the tendency of employees to leave the company soon after returning from international assignments. This is a global issue, which causes the firm to lose both its investment in the employee and the potentially valuable tacit knowledge that the employee has gained as an expatriate. It is arguably an especially salient issue in the Bangalore IT cluster under study, given the relative ease of shifting to another firm, absent the need to relocate or reconfigure one's personal network. Considering different aspects of organizational commitment, Muthiah and Santosh find that affective commitment is particularly important, and highlight the importance of effective repatriation processes that are tailored to each company.

Chapter 16 continues the theme of employees' relationships with their employers. In "Challenges in Employee Engagement in Emerging Economies", Arun Sacher and Ankur Lal use secondary data to develop a review of the state of employee engagement, with a focus on the BRICS (Brazil, Russia, India, China, and South Africa) nations. Finding clear distinctions among the five countries, Sacher and Lal suggest the importance of understanding the underlying drivers of each environment's institutional and cultural strengths and weaknesses, in terms of the potential for increasing levels of employee engagement.

In "The Combined Use of Formal and Informal Ethics Training in the Indian IT Companies" (Chap. 17), Pratima Verma and Siddharth Mohapatra employ a mixed-methods research design to investigate another aspect of organizational culture that pertains to corporate governance: the communication and implementation of ethical values within firms in the Indian IT sector. Verma and Mohapatra conclude that a mix of formal (e.g., lectures) and informal (e.g., ethics-related newsletters, videos, and role-playing) training is particularly well-suited to communicating the importance of ethical behavior in this internationally active industry that is so important to India's economic well being.

"Leadership Excellence in Organizations in the Mekong Region: A Comparative Study of Thailand, Cambodia, Lao, and Vietnam" (Chap. 18), by Christopher Selvarajah and Denny Meyer, makes use of a cultural lens, including the different religious perspectives that underpin value systems, to investigate leadership in Southeast Asia. Extending the existing literature, Selvarajah and Meyer develop and estimate a culturally driven model to understand the determinants of excellence in leadership across the five countries in the Mekong region. The findings of this study offer contextually embedded guidance to firms seeking to enter these markets.

Doing Well or Doing Good? Two Views of CSR in India

The final section of this volume presents two perspectives on an issue of special pertinence to firms doing business in India—finding ways to engage with, support, and provide opportunities to the vast numbers of people living at the Base of the Pyramid (BoP).

In "Mandated Corporate Social Responsibility (Mcsr): Implications in Context of Legislation" (Chap. 19), Kajari Mukherjee discusses the benefits and challenges associated with mandating, as opposed to encouraging, businesses to engage in corporate social responsibility (CSR) activities, focusing on the Indian government's 2013 legislation that requires large companies to dedicate 2 % of their net profit to contribute to social good, such as reducing poverty and improving the environment. Mukherjee articulates some of the important distinctions between the more typical approach, in which financial support for CSR is a voluntary decision, and the Indian approach, in which both the decision and the level of support are legislated.

The volume concludes with Chap. 20, "Connecting the Base of the Pyramid to Global Markets Through E-commerce: A Case Study of BAIF (India)", by Raji Ajwani-Ramchandani. This case-based study describes how linkages between foreign MNEs and local nongovernmental organizations (NGOs) offer the potential to generate outcomes that benefit both the MNEs and the staggeringly large population of Indians living in BoP conditions. Ajwani-Ramchandani discusses both successes and setbacks in the NGO's (BAIF's) efforts to establish a process that allows BoP farmers and producers to access global customers through e-commerce channels, and concludes with a conceptual model that suggests how linkages between NGOs and MNEs can enhance the firms' abilities to access the BoP markets—as both customers and suppliers—while providing opportunities for BoP producers to access international customers for their output and increase their incomes.

Conclusion

As a whole, the chapters of this book attempt to convey a holistic understanding of various aspects of doing business in the context of emerging markets, particularly India, from a variety of starting points, linked by the intent of building on institutionally informed perspectives. The result is a multidisciplinary research agenda, encompassing insights from a range of the functional areas associated with the broad field of international business. We hope that this collection will stimulate new thinking and research, drawing on the insights of scholars with deeply embedded understandings of how institutional frameworks affect firm-level outcomes, both at home and globally.

References

Ramamurti, R. (2012). What is really different about emerging market multinationals. *Global Strategy Journal, 2*, 41–47.

UNCTAD. (2015). *World investment report 2015: Reforming international investment governance*. Geneva: United Nations Publication.

UNCTAD. (2016). UNCTAD statistics. Available at http://unctad.org/en/Pages/Statistics.aspx

Part I

International Strategy in the Emerging-Market Context: The Big Picture

2

Taking Stock of the Principal–Principal Agency Perspective: A Review and the Way Ahead

Kshitij Awasthi

Introduction

Governance has been one of the major issues faced by corporations ever since the industrial revolution. In his book, *The Wealth of Nations*, Adam Smith (1776) provided the first recognized instance of governance-related discussion by expressing concern about examining the organizational and public policy consequences of the separation of ownership and control in large firms. However, it was the groundbreaking work of Berle and Means (1932), addressing the concerns of Smith (1776) almost 150 years later, which led to a theory of governance in modern enterprises that have both widely dispersed ownership and separation of ownership and control. They conceptualized that owners of modern corporations are different from controllers (managers); this idea became the basis for a rich stream

---

K. Awasthi (✉)
Indian Institute of Management Bangalore, Bangalore, India
e-mail: kshitijawasthi@yahoo.co.in

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_2

of research. Jensen and Meckling (1976: 311) proposed that the firm is "a nexus of contracts" and that there is the divergence of interest between principals (owners) and agents (managers). This divergence of interest leads to what is known as "agency cost". One of the principal objectives of corporate governance is to minimize these agency costs, by creating incentive systems to align the interests of agents (who are assumed to be opportunistic and self-interested) with those of principals and/or by providing proper monitoring mechanisms.

Principal–agent relations have been studied widely in a developed-economy context in the corporate governance literature. Agency theory has become one of the major theoretical perspectives used to understand corporate governance, in general, and board structure, board functions, and CEO compensation, in particular. However, in several other economic contexts, particularly emerging economies, the institutional structure leads to concentrated ownership, and a different kind of agency conflicts—between majority (controlling) and minority shareholders (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008), usually termed as principal–principal relations (Dharwadkar, George, & Brandes, 2000). The past two decades of research on institutional theory have led to better understanding of the impact of institutional environments, and the emergence of the principal–principal governance model in studies set in emerging and transition economies. Young et al. (2008) provided the first major conceptual overview of principal–principal research. However, the field has witnessed considerable scholarship since then, and progress has been made, particularly with respect to empirical testing of the previously laid theoretical groundwork. This chapter builds on the conceptual overview of Young et al. (2008), synthesizing significant developments in this subfield of corporate governance on both the theoretical and empirical fronts. Another major focus area of the chapter is to provide directions for future research, in order to continue to develop our understanding of corporate governance in general, and the principal–principal issue in particular.

The remainder of the chapter is structured as follows. A comparison of the traditional agency and principal–principal perspectives is followed by an overview of institutional aspects of corporate governance in the context of emerging economies and exposition of a conceptual stream of research pertaining to the principal–principal model. The remaining section reviews recent developments in the empirical testing agency theory in emerging markets, and the chapter concludes with discussion and directions for future research.

Principal–Agent and Principal–Principal Conflicts

Traditional agency relations involve the principal, the agent, and the contractual relationship between them. The agency problem occurs because of differences in the interests and risk-appetites of the principal and the agent, and the difficulty associated with the monitoring of the agent's behavior by the principal (Eisenhardt, 1989). Agency theory is based on the assumption that people are self-interested, risk-averse, and driven by bounded rationality. This agency model has been applied widely both in descriptive and normative studies of corporate governance. However, researchers have recognized that this agency model, alone, does not capture the corporate governance practices across all institutional (La Porta, Lopez-de-Silanes, & Shleifer, 1997, La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998) and national contexts (Aguilera & Jackson, 2003). The traditional model of agency theory, or the principal–agent problem, is applicable to developed economies, particularly in Anglo-American contexts that are characterized by relatively better enforcement of property rights (Peng, 2003). Given that ownership and control are largely separated in these legal environments, principal–agent conflicts are the primary focus of practice and research.

This model, however, does not necessarily reflect the agency relations and corporate governance practice in other institutional contexts, as those of emerging economies. The emerging-market institutional context makes the enforcement of agency contracts difficult, due to weak formal and informal institutions (North, 1990). To reduce agency costs in such contexts, corporations tend to have more concentrated ownership (Dharwadkar et al., 2000). This, to some extent, solves the traditional agency issue. However, concentrated ownership, combined with an absence of effective external governance mechanisms, is expected to result in more frequent conflicts between controlling shareholders and minority shareholders (Morck, Wolfenzon, & Yeung, 2005). Consideration of the effect of institutional context on corporate governance led to the principal–principal model, which focuses on the conflicts between different sets of principals within the firm (Young et al., 2008), particularly on conflicts between controlling and minority shareholders (Dharwadkar et al., 2000). Thus, principal–principal conflicts can be viewed as resulting from concentrated ownership, extensive family ownership and control, business group structures, and weak legal protection of minority shareholders (Young et al., 2008).

Table 2.1 Comparison of traditional principal-agent model and principal-principal models

	Principal-agent agency model	Principal-principal agency model
Agency cost	Due to divergence of interests between shareholders (principal) and managers (agent)	Due to possibility of expropriation of minority shareholders by the controlling shareholder group
Institutional context	Majorly developed countries	Majorly emerging/transition economies
Assumptions	Bounded rationality, opportunism, self-interest, maximizing agents	Controlling shareholders maximizing wealth even at the cost of minority shareholders, managers follow majority owners' objectives
Reasons for conflict	Opportunism and self-interest behavior by managers in dispersed ownership	Expropriation of minority shareholders by large shareholders and their appointed managers due to weak minority shareholder protection
Concept of shareholders	Homogeneous group	Heterogeneous (controlling and minority)
Largest shareholders	Hardly visible, not too strong	State-owned enterprises, family ownership, pyramid ownership
Role of boards	Monitoring agents	Negligible, facilitating majority shareholder's interest
Forms of expropriation	Managerial entrenchment, empire building, private benefits to managers	Below market value asset transfers to controlling owner, personal/private benefits of large controlling shareholders
Liquidity of stocks	Usually high	Generally low

Thus, it can be asserted that the principal–agent and principal–principal agency models have different antecedent institutional environments and distinguishing between them should, therefore, be useful in analyzing corporate governance issues in the applicable institutional contexts. It is pertinent, then, to understand the fundamental differences in assumptions and application between these models, so as to have a clearer picture of corporate governance practices in developed and emerging economies. Table 2.1 provides a comparison between the two agency models on some key dimensions of corporate governance.

Corporate Governance in Emerging Economies

The major difference between the two types of agency models (principal–agent and principal–principal) comes from the underlying institutions in which they are applicable. Institutions have two crucial constituents—environment and arrangements (Davis & North, 1971). The institutional environment refers to the background constraints or "rules of the game" that guide individuals' behaviors (North, 1990). These rules can be both formal and explicit (e.g., constitutions, laws, property rights) and informal and often implicit (e.g., social conventions, norms). The institutional environment forms the framework in which human action takes place. North (1990: 4) asserts that institutions "define and limit the set of choices of individuals". Institutional arrangements, on the other hand, are specific guidelines that are also referred to as "governance structures". Coase (1937, 1960) made the crucial connection among institutions, transaction costs, and neoclassical theory. The neoclassical result of efficient markets only eventuates when it is costless to transact; however "when it is costly to transact, institutions matter" (North, 2006: 2). The institutional context in general, and property rights in particular, are crucial determinants of the efficiency of markets and of corporate governance practices which differ substantially between emerging/transition economies and developed economies.

Emerging economies can be defined as "low-income, rapid-growth countries using economic liberalization as their primary engine of growth" (Hoskisson, Eden, Lau, & Wright, 2000: 249). These economies are further characterized by their attempt to transition toward market-based mechanisms, rather than the traditional relation-based system, due to internal need or external pressure (Peng, 2003). In other words, the transition signifies the state when an emerging economy is in the process of moving from a "relation-based" to a "rule-based" system (Peng, Lee & Wang, 2005). However, this transition is generally not smooth; formal rules may change overnight, but informal rules take time to change (North, 1991), as a result of institutional stickiness that is also known as "institutional rigidity" or "path dependence" (North, 1994).

The institutional differences between developed and emerging economies come from formal rules (e.g., relatively weaker property rights/contract law, ambiguous role of boards, less protection for minority shareholders), as well as informal rules (e.g., prevalence of family-owned business, preferential pricing for group companies). Even more pressing is the weak enforcement of prevailing laws in emerging economies. This weak enforcement leads to different types of conflicts within emerging-economy organizations. The principal–agent conflict, as described by Jensen & Meckling (1976) and others, may not, thus, account for conflicts typical in emerging economies. Indeed, some researchers have noted that standard corporate governance mechanisms have relatively little institutional support in emerging economies (Peng, 2004; Peng, Buck, T. & Filatotchev, 2003).

Thus, the institutional context in emerging economies lends itself to a different type of agency issues, principal–principal conflicts, created by concentrated ownership and control and inadequate institutional protection of minority shareholders. Emerging-economy contexts include weak governance practices such as fewer publicly traded firms (La Porta et al., 1997), information asymmetry and abuse (Morck, Yeung, & Yu, 2000), and expropriation of minority shareholders (Claessens, Djankov, & Lang, 2000; Faccio, Lang, & Young, 2001). These arrangements lead to lower levels of dividend payouts (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000) and, ultimately, to lower firm valuations (Claessens, Djankov, Fan, & Lang, 2002; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2002).

When an economy grows and moves toward a market-based system, the transition may be in the best interest of the future prospects for "threshold firms", which are near the point of transition from a founder-based system to a professionally managed firm (Daily & Dalton, 1992). However, due to ambiguity over the law, problems with implementation and the potential for short-term disadvantage often lead owners to retain control even during transition. Moreover, failure to make the transition may worsen principal–principal conflicts (Young et al., 2008). This situation results in the continuance of informal institutions such as relational ties, business groups, family business, and government contacts all playing greater roles in shaping corporate governance (Peng & Heath, 1996; Yeung, 2006).

In summary, it can be asserted that the corporate governance practices in emerging economies often differ substantially from those in developed economies (Backman, 1999; Peng, 2004). Hence, the corporate governance in emerging economies leads to a different set of agency issues, specifically principal–principal conflict, which is becoming a major area of interest among corporate governance scholars studying emerging economies.

The State of Research in Principal–Principal Conflicts

Research on the traditional agency model highlights several governance mechanisms aimed at reducing conflict. These governance mechanisms are both external (e.g., product market competition and the market for corporate control) and internal (e.g., concentrated ownership, CEO compensation, and the board of directors). The optimal combination of these interdependent mechanisms (Jensen, 1993) leads to effective corporate governance. However, the efficiency of such a mechanism varies across institutional contexts; different countries have different efficiencies pertaining to external and internal control mechanisms (La Porta et al., 1997, 1998, 2002). The institutional setting in emerging economies calls for a "different bundle of governance mechanisms since the corporate governance conflicts often occur between two categories of principals—controlling shareholders and minority shareholder" (Young et al., 2008; 199). Therefore, corporate governance research set in emerging economies needs to look at governance mechanisms that are different from those employed in developed-economy contexts.

The principal–principal conflict, though a relatively new topic of governance research, has evolved in several directions. Key areas of investigation have been about the primary drivers of conflict (Young et al., 2008), the effect of principal–principal problems on various life cycle stage of firms (Zahra & Filatotchev, 2004), means of expropriation by dominant shareholders (Faccio et al., 2001; Chang & Hong, 2000; Khanna & Rivkin, 2001), and comparisons of empirical evidence of the two agency models (Bruton, Filatotchev, Chahine, & Wright, 2010). These are discussed in more detail.

Primary Drivers of Conflict

Dominant Ownership

This aspect of principal–principal conflict has drawn considerable research attention. First, considering reasons for concentrated ownership, one stream of literature discusses that "threshold" firms—those in transition from founder to professional management—experience the need to provide some private information to outsiders (Daily & Dalton, 1992), something that had not been required under the previous governance regimes. This disclosure of information requires that the founding family place its trust (Zahra & Filatotchev, 2004) in a new set of professional managers. This trust may be particularly difficult to achieve in an emerging economic environment (North, 1990). Moreover, institutions that might facilitate such trust may be lacking in emerging economies, which make crossing the threshold from dominant to dispersed ownership more difficult (Young et al., 2008). The second issue cited commonly is the presence of both external and internal corporate governance mechanisms. As discussed above, developed economies are more likely to provide something close to an optimal bundle of mechanisms (Fama & Jensen, 1983) to facilitate smooth corporate governance. Key external governance mechanisms, such as product and labor markets, or markets for corporate control, are more mature in developed economies; in contrast, the governance mechanisms in emerging economies may not be efficient enough with respect to forcing managers to behave in the interest of shareholders (Djankov & Murrell, 2002). Similarly, internal governance mechanisms (board structure and independence, monitoring and control rights) in emerging economies are also weaker (Fama & Jensen, 1983), meaning that firms are forced to rely on dominant ownership to keep potential managerial opportunism in check (Dharwadkar et al., 2000). The social antecedents of dominant ownership have also been studied; Young et al. (2008), for example, identified three sets of institutional antecedents of concentrated ownership: family businesses, business groups, and state-owned enterprises (SOEs).

Family Businesses In emerging economies, controlling ownership is often in the hands of a family (La Porta, Lopez-de-Silanes, & Shleifer, 1999). This has both costs and benefits. On one hand, it reduces agency costs by aligning ownership and control. Family ties assist firms in reducing monitoring costs, which may lead to enhanced performance (Young et al., 2008). On the other hand, family ownership and control may also increase the possibility of expropriation of other minority shareholders by family shareholders, negatively affecting the firm. Further, family owners may not allocate resources efficiently, and may give preference to social relations over efficiency. This inefficiency can be reflected in outcomes such as the appointment of under-qualified family members to key posts (Claessens et al., 2000), non-merit-based compensation, and inefficient strategic decisions.

The net advantage or disadvantage of family control depends upon a myriad of factors. Family firms tend to perform well in low-munificence and complex, but highly dynamic, environments, while struggling in converse scenario (Gedajlovic, Lubatkin, & Schulze, 2004; Young et al., 2008).

Business Groups A business group is “a collection of legally independent firms that are bound by economic (such as ownership, financial and commercial) and social (such as family, kinship and friendship) ties” (Yiu, Bruton, & Lu, 2005: 183). Usually, each of the member firms in a business group is a distinct business entity, in legal terms (Young et al., 2008). In many emerging economies, business groups and family businesses are coalesced; that is, various group companies are owned by different family members. Though business groups are commonplace in many developed economies, they are relatively more widespread in emerging economies (Peng, Lee, & Wang, 2005; Yiu et al., 2005).

A business group structure may provide more advantage in emerging economies (Chakrabarti, Singh, & Mahmood, 2007; Khanna & Palepu, 2000). Internal resource allocations among constituent firms become particularly important in emerging economies, due to less developed markets for critical resources such as capital. Often, emerging economies lack a well-functioning external capital market. Even if the external capital market is fully functional, firms within a business group are sometimes denied external capital because they are not able to signal value creation from specific projects, especially if group resources are tied up with multiple ongoing projects (Myers & Majluf, 1984). The business group's internal capital market provides an alternative, and creates value by efficiently allocating resources among member firms (Stein, 1997); nonetheless, business groups also have to bear coordination and administration costs (Claessens et al., 2002).

The business group also escalates the opportunity for expropriating minority shareholders by inefficient and veiled resource transfers, thus affecting minority shareholder interests in some member firms. For example, to help a group firm, inputs from a sister firm may be bought at higher-than-market prices, or output can be sold to a sister firm below market price. Similarly, a group company can invest in projects of other group firms, even if this is not fully economically desirable. This is arguably more likely to happen when the control rights of the controlling shareholders are greater than their cash flow rights, which can lead to a practice known as "pyramiding" (Bertrand, Mehta, & Mullainathan, 2002; Claessens et al., 2002). For example, consider that Firm A has 50 % control over Firm B, which, in turn, has 50 % control over Firm C. In this case, Firm A has a 25 % cash flow right in Firm C, but more like 50 % control right, given its ability to also act through Firm B. Under such conditions, owners have the ability to divert resources from Firm C to Firm A, so as to enjoy better cash rights. The literature on internal capital markets suggests that business groups are prone to over-investment and lobbying costs (Rajan, Servaes, & Zingales, 2000), thereby reducing value.

In summary, principal–principal conflict is viewed as more likely to surface in emerging markets, where business groups are known to give preferential treatment to some member firms, over and above economic and efficiency considerations.

State-Owned Enterprises In emerging economies, for social, political, and historical reasons, many of the largest firms are controlled by the state. For example, Xu and Wang (1999) note that, in China, about two-thirds of the shares in publicly listed companies are owned by the state, either directly or through other SOEs. Dharwadkar et al. (2000) note the prevalence of SOEs in emerging economies, asserting that, even post-privatization, the structure of several SOEs resembles their previous structures, at least in practice, due to rigidities associated with the systematic involvement of insiders, including managers, employees, and the state. This insider dominance in privatized firms risks the creation of principal–principal agency issues (Dharwadkar et al., 2000).

Means of Expropriation by Controlling Shareholders

The mechanisms employed in the expropriation of minority shareholders represent another area that has drawn attention of scholars in this field. This stream of research looks at the methods or instruments by which controlling shareholders fulfill their objectives at the cost of minority shareholders. Faccio et al. (2001), for example, found that controlling owners may put less than fully qualified family members, friends, and associates in key positions, thereby reducing efficiency that could have been gained by selection of professional on an arm's length basis. Moreover, controlling shareholders may engage in the purchase of inputs at higher-than-market price and/or the supply of output at lower-than-market price, to firms that they own or with which they have some association (Chang & Hong, 2000; Khanna & Rivkin, 2001). Social and political objectives may mean that the benefits of such preferential treatment may accrue to firms owned by other family members, a sister concern in the business group, or other SOEs. Backman (1999) also looked at the possibility of engaging in suboptimal strategies that advance personal or family agendas (political/social, in many cases) at the expense of firm performance, including excessive diversification and empire building.

Other Areas

Apart from those discussed above, some research has touched peripheral areas, such as the differential effect of principal–principal conflict on firms at different life cycle stages. In an empirical study, Zahra and Filatotchev (2004), for example, found that young entrepreneurial firms are more likely than mature firms to face principal–principal agency issues. Recently, researchers have also tried to disentangle the effects of both agency-related conflicts—principal–agent and principal–principal—suggesting a multi-agency perspective (e.g. Bruton et al., 2010).

Principal–Principal Agency Costs and Firm Performance

Young et al. (2008) discuss three reasons why these costs may be higher in emerging economies: (1) ambiguous institutional structures (North, 1990; Peng, 2003) that can lead to higher costs of measuring contract terms, (2) less effective boards of directors, due to the propensity of top managers to also be controlling shareholders (Dharwadkar et al., 2000), and (3) decreased liquidity due to ownership concentration (Morck et al., 2005). Additionally, as discussed at some length in the last section, some researchers have argued that principal–principal conflicts also affect organizational performance by "corrupting firm strategy" (Young et al., 2008: 209).

The issues mentioned above may affect the cost of capital and cause severe damage to firms' sustainability. First, the cost of external capital increases because minority shareholders, understanding expropriation risks, may demand higher returns in the form of dividends (Gomes, 2000; Lins, 2003). Second, cost of equity can rise, due to the under-pricing of public offering resulting from the possibility of principal–principal agency conflict (Gomes, 2000). As external financing becomes difficult or costly, firms need to rely on internal financing, which may lower their market capitalization, especially in emerging economies (La Porta et al., 1998, 2002).

In most of the scenarios, as discussed previously, minority shareholders risk being expropriated, and may be incentivized to exit the market. A fundamental question here is why minority investors remain in the market, despite the higher possibility of expropriation. In other words, in principal–principal agency issues, how do controlling shareholders attract minority shareholder investors? Young et al. (2008: 208) argue that, in this case, the controlling shareholders may need to incur "bonding costs" as a type of implicit guarantee against expropriation. These bonding costs may take various forms, including developing "a reputation for treating minority shareholders well" (Gomes, 2000: 616).

To summarize, principal–principal conflicts may undermine the firm's competitiveness and discourage investor participation, which, in turn, increases the cost of capital through higher dividends and lower prices for equity offerings. To save themselves from this long-term disadvantage, firms facing this type of agency conflict probably need to either transform themselves into professionally run organizations or attempt to reduce agency costs by taking measures such as building a reputation for engaging in fair practices.

Overview of Recent Empirical Studies and Methodology

There seems to be broad consensus among corporate governance scholars that traditional agency models alone can neither describe nor prescribe corporate governance practices for firms in emerging economies. This is a primary factor behind the prominence that principal–principal agency models have gained for studying corporate governance practices in such contexts. The development of this subfield has been rather rapid. From a focus on theoretical development over the past two decades, it has started to produce a flurry of empirical studies in recent years; see Table 2.2. The areas addressed in the empirical research have been quite varied; some of these are discussed briefly in the following paragraphs.

Type of Ownership As noted in the section on conceptual developments, type of ownership has been a major area of empirical research in this subfield. Ownership types considered to date have included family firms

Table 2.2 Some recent empirical studies on principal-principal agency relations

Authors	Study	Method and sample	Data analysis	Results
Su, Xu and Phan (2008)	Principal–principal problem in boards of Chinese publicly listed companies	Six years panel data of listed Chinese firms in two stock exchanges	Feasible generalized least squares (FGLS) regression	Curvilinear (U-shape) relationship between ownership concentration and principal–principal agency cost
Chen and Young (2010)	Cross-border mergers and acquisitions by Chinese-listed companies	39 cross-border mergers and acquisitions by Chinese companies between 2000 and 2008	Event study, instrumental variable, multiple regression	Investors look unfavorably to state-dominant acquirers in overseas mergers and acquisitions
Bruton et al. (2010)	Multiple agency theory, impact of venture capitalist and business angels in determining IPO performance in UK and France	Hand-collected data of 224 IPOs (112 each from France and the UK), multi-method	Matched pair and two-stage least squares (2SLS) regression	Effect of ownership concentration on corporate governance varies with institutional context
Lu, Xu, and Liu (2009)	Impact of corporate governance and institutional environments on the export behavior of firms in emerging economies	779 Chinese-listed manufacturing firms for the period of 2002–2005	Random effect Tobit and GMM models	Principal–principal conflict affects (inverted U) the export-related decision in emerging economies.

Peng and Jiang (2010)	Family ownership and control in large firms and role of legal and regulatory institutions	Event study of 634 publicly listed large family firms in seven Asian countries around the Asian financial crisis	Ordinary least squares (OLS) regression	The net balance of the benefits and costs of family control in large firms depends on the legal and regulatory institutions governing investor protection.
Renders and Gaeremynck (2012)	Impact of principal–principal agency problems on the quality and effectiveness of corporate governance structures	1064 year-firm observations from 14 European countries	Factor analysis and simultaneous equation modeling	There is some cost of installing good governance, but it creates value in long run.
Ward and Filatotchev (2010)	Agency problems associated with mutual and joint stock organizational forms	Panel data set consisting of 42 UK life insurance companies over the period 1990–1997	Dynamic panel data estimation	Mutuals have higher principal–agent and principal–principal costs, compared with stocks; independent distribution mitigates both agency problems.

(*continued*)

Table 2.2 (continued)

Authors	Study	Method and sample	Data analysis	Results
Bhaumik et al. (2010)	Impact of ownership structures of emerging-market firms on the decision to undertake outward FDI	Panel data for 2000–2006, on 196 automotive and 581 pharmaceutical firms of Indian ownership	Panel data Tobit maximum likelihood estimation	Family firms and firms with concentrated ownerships are less likely to invest overseas.
Jiang and Peng (2010)	Principal–principal conflicts during crisis	877 publicly listed large corporations with concentrated ownership in seven Asian countries and regions	2SLS regression	Family firms tend to choose certain control structures associated with potential principal–principal conflicts.
Jiang and Peng (2011)	Effect of concentrated family ownership and control on firm performance	744 publicly listed large family firms in eight Asian countries	OLS regression	Concentration effect varies across countries, but is irrelevant at aggregate level.
Hu et al. (2009)	Effects of internal governance mechanisms in enhancing firms' value in China	3-year (2003–2005) panel data covering 304 Chinese publicly listed companies	Structural equation modeling	Ownership concentration has significant negative governance effect.
Chen et al. (2011)	Whether adopting OECD-prescribed corporate governance principles can solve the major corporate governance problems in an emerging economy	Panel data of over 1100 Chinese-listed firms between 2001 and 2003	Fixed-effect panel OLS regression	"Good governance practices" in OECD countries do not mitigate the principal- principal issue.

Filatotchev et al. (2011)	How family control affects private information abuses and firm performance in emerging economies	447 companies listed on Hong Kong Stock Exchange in 2006	2SLS regression	Family ownership and family board dominance increase private information abuse risk.
Banchit et al. (2011)	Impact of principal–principal conflicts on performance in Islamic banking	Panel data (2005–2010) of 37 banks that adopt Islamic banking in 10 countries	Feasible generalized least square (FGLS)	Principal–agent is the primary concern with inconclusive results for principal–principal conflicts.
Banchit and Locke (2011)	Principal–principal cost and conflict in large publicly listed companies in four ASEAN countries	193 listed companies from four ASEAN countries	OLS regression	Principal–principal cost is a major problem in ASEAN markets.
Shan (2014)	Impact of internal governance mechanisms on audit quality	Panel data (2001–2005) of 117 Chinese companies	Logistic regression	Foreign ownership and number of professional supervisors are positively related, and the size of the supervisory board is negatively related, to audit quality

(Peng & Jiang, 2010; Jiang & Peng 2011; Filatotchev, Zhang, & Piesse, 2011), business groups (Bhaumik, Driffeld, & Pal, 2010), and SOEs (Su, Xu, & Phan, 2008; Chen & Young, 2010).

Strategic Decisions and Industry Contexts Several studies link principal–principal conflict to strategic decisions, investigating its effect on cross-border mergers and acquisitions (Chen & Young, 2010), IPOs (Bruton et al., 2010), the internationalization process (Lu, et al., 2009), outward foreign direct investment (FDI) (Bhaumik et al., 2010), and performance during crisis (Jiang & Peng, 2010). However, this research has tended not to focus industry-specific contextualization; most studies have employed mixed-industry data, apart from exceptions pertaining to the automotive and pharmaceutical (Bhaumik et al., 2010) and insurance (Ward & Filatotchev, 2010) industries.

National Contexts The extant literature in this subfield has focused strongly on the Chinese context (Su et al., 2008; Chen & Young, 2010; Lu et al., 2009; Hu, Tam, & Tan, 2009; Chen, Li, & Shapiro, 2011; Filatotchev et al., 2011; Banchit, Locke, Abidin, & Wellalage, 2011; Shan, 2014) and Association of South East Nations (ASEAN) countries (Peng & Jiang, 2010; Jiang & Peng, 2010, 2011; Banchit & Locke, 2011). However, other national contexts have also been addressed, including India (Bhaumik et al., 2010) and the BRIC (Brazil, Russia, India, and China) countries (Estrin & Prevezer, 2011). Moreover, particularly interesting for the development of the subfield have been the studies testing principal–principal perspective in developed countries, including the UK (Ward & Filatotchev, 2010), France and the UK (Bruton et al., 2010), and 14 European countries (Renders & Gaeremynck, 2012); in addition, Banchit et al. (2011) considered this issue in the context of Islamic banking. Evidence of principal–principal conflict in developed economies (e.g., Ward & Filatotchev 2010) is particularly promising in terms of theory development.

Methodology

As evident from Table 2.2, most of the empirical research has concentrated on quantitative studies based on secondary financial market data.

Although there have been some cross-sectional studies (e.g., Banchit & Locke, 2011; Filatotchev et al., 2011), most of the studies have used a panel data approach. As far as data analysis is concerned, Table 2.2 reflects a wide variety in the techniques used, including ordinary least squares (e.g., Banchit & Locke, 2011; Peng & Jiang, 2010), two-stage least squares (Filatotchev et al., 2011), logistic regression (Shan, 2014), and simultaneous equation modeling (Hu et al., 2009).

Discussion and Future Research Direction

Based on the previous discussion, it can be seen that there has been a considerable amount of conceptual development in the field of principal–principal agency. The broad areas of enquiry have been those pertaining to institutional antecedents of principal–principal conflicts, the *modus-operandi* of expropriation of minority shareholders, and solutions to these problems. On the empirical front, the lack of consensus on constructs and measurement initially hindered hypothesis testing. However, over the years, there has been noticeable surge in the number of empirical studies involving use of different operationalizations of constructs. The empirical studies in this relatively nascent field have been quite varied, and these have shown enough evidence regarding the topic to give rise to the expectation of future developments in the field.

Implications and Future Research Direction

This chapter has attempted to provide a conceptual overview of the development of the subfield of principal–principal agency, with particular emphasis on the empirical front. Though there have been fast-paced developments in the subfield, there is still much more to understand, both conceptually and empirically. The evidence of principal–principal conflicts in developed economies has opened the floodgates for future research on corporate governance. This evidence provides not only an opportunity to compare institutional context in corporate governance studies but also shows a way forward for the multi-agency perspective to be used to develop stronger explanation of corporate governance practices.

While many studies addressing this perspective have focused either on China or on ASEAN countries, there remains a clear opportunity to extend our understanding of principal–principal conflicts in the context of other emerging markets, particularly India. Further, studies addressing specific industry contexts will enable researchers to control for industry-wide differences in corporate governance practices in particular institutional contexts, and allow for micro-understanding of the institutions prevailing in such economies. Pertinent cases for developing deeper insights might include more regulated industries, such as airlines and petroleum/mining, along with less regulated industries, such as retailing. More institutional-level classifications of economies, based on legal system or property rights, including comparisons of civil law and common law contexts, will add nuanced understanding and build on the developed versus emerging-economy dichotomization in the corporate governance context. As an example, Bruton et al. (2010) compare two developed countries—the UK and France—which have different legal systems, and identify significant variation in the corporate governance practices in these two countries.

On the other hand, it might be helpful to question even the micro-foundations of principal–principal conflicts. For example, until now, scholars have been considering "family" as a homogeneous unit in family-run business. However, differences in interest among family members within these firms are observed quite often in emerging economies; such differences may lead to within-family agency issues. In the same vein, studies that compare economies within more similar institutions (e.g., BRIC, which are considered emerging economies) on various dimensions of corporate governance (e.g., family businesses, business group characteristics, or the nature of SOEs) can further tease out distinctions and enhance our understanding.

Similarly, more work is needed regarding the social embeddedness of organizations, which may lead to institutional rigidity. For example, in many emerging economies, for a family member to assume the business leadership of the firm is a norm, and the appointment of a new leader from outside of the family does not elicit a positive response from investors. Such norms are social phenomena and characteristics of the underlying institution. Nonetheless, understanding and accounting for such norms is important for researchers and practitioners alike.

In broad conceptual terms, more multi-agency studies are required for theory development as well as for a better understanding of corporate governance practices. Development on this front can lead to a grand theory of agency, which can potentially be generalized to a higher degree. On the empirical front, longitudinal case studies of corporate governance practices and their evolution, in both developed- and emerging-economy contexts, will shed light on the evolutionary aspects of these issues.

Overall, apart from these potential areas of development, the principal–principal perspective also needs to address many questions moving further afield. Examples include the role of managers in the principal–principal setting, and the impact of basic tenets of decision-making related to corporate finance (e.g., capital structure, financing, diversification). Even more challenging will be distinguishing between deliberate and specifications related to minority shareholder expropriation from those that are based on strategic choice and that may cause harm to both minority and controlling shareholders. Extending this further, it will be interesting to understand more about whether preference for social objectives, over purely economic objectives, by SOEs should be considered as minority shareholder expropriation. Also, should banking/financial institutions be considered equivalent to "minority shareholders" that are vulnerable to expropriation by controlling shareholders in institutional settings characterized by weak property rights regimes?

In summary, by addressing these issues, contributions can be made to several fields, particularly institutional theory and corporate governance. Such research offers the potential to extend agency theory, to increase its predictive and explanatory power related to corporate governance across institutions, while providing clearer understanding of institutions per se. As institutions are central to both the principal–principal perspective and institutional theory, a better understanding of institutions can address, to some extent, the concern Williamson (2000: 595) expressed, noting that "we are still very ignorant about institutions".

References

Aguilera, R. V., & Jackson, G. (2003). The cross-national diversity of corporate governance: Dimensions and determinants. *Academy of Management Review, 38*, 447–465.

Backman, M. (1999). *Asian eclipse: Exposing the dark side of business in Asia*. Singapore: Wiley.

Banchit, A., & Locke, S. (2011). Principal-principal conflicts: Is it a big problem in ASEAN 4 markets? *International Review of Business Research Papers, 7*, 1–15.

Banchit, A., Locke, S., Abidin, S., & Wellalage, N. H. (2011). *Do principal-principal or principal-agent conflicts impact the performance of Islamic banking?* Working paper No. 1930105, SSRN. [Online] Available from: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1930105&download=yes

Berle, A. A., & Means, G. C. (1932). *The modern corporation and property*. New York: Harcourt.

Bertrand, M., Mehta, P., & Mullainathan, S. (2002). Ferreting out tunnelling: An application to Indian business groups. *Quarterly Journal of Economics, 117*, 121–148.

Bhaumik, S. K., Driffeld, N., & Pal, S. (2010). Does ownership structure of emerging-market firms affect their outward FDI? The case of the Indian automotive and pharmaceutical sectors. *Journal of International Business Studies, 41*, 437–450.

Bruton, G., Filatotchev, I., Chahine, S., & Wright, M. (2010). Governance, ownership structure and performance of IPO firms: The impact of different types of private equity investors and institutional environments. *Strategic Management Journal, 31*, 491–509.

Chakrabarti, A., Singh, K., & Mahmood, I. (2007). Diversification and performance: Evidence from East Asian firms. *Strategic Management Journal, 28*, 101–120.

Chang, S. J., & Hong, J. (2000). Economic performance of group-affiliated companies in Korea: Intragroup resource sharing and internal business transactions. *Academy of Management Journal, 43*, 429–488.

Chen, V. Z., Li, J., & Shapiro, D. M. (2011). Are OECD-prescribed “good corporate governance practices” really good in an emerging economy? *Asia Pacific Journal of Management, 28*, 115–138.

Chen, Y. Y., & Young, M. N. (2010). Cross-border mergers and acquisitions by Chinese listed companies: A principal–principal perspective. *Asia Pacific Journal of Management, 27*, 523–539.

Claessens, S., Djankov, S., Fan, J., & Lang, L. (2002). Disentangling the incentive and entrenchment effects of large shareholdings. *Journal of Finance, 57*, 2741–2771.

Claessens, S., Djankov, S., & Lang, L. (2000). The separation of ownership and control in East Asian corporations. *Journal of Financial Economics, 58*, 81–112.

Coase, R. H. (1937). The nature of the firm. *Economica, 4*(16), 386–405.

Coase, R.H. (1960), 'he problem of social cost, J*ournal of Law and Economics*, *3*, 1–44.

Daily, C. M., & Dalton, D. R. (1992). Financial performance of founder-managed versus professionally managed small corporations. *Journal of Small Business Management, 30*, 25–34.

Davis, L. E. & North, D. C. *Institutional change and American economic growth*. New York: Cambridge University Press.

Dharwadkar, R., George, G., & Brandes, P. (2000). Privatization in emerging economies: An agency theory perspective. *Academy of Management Review, 25*, 650–669.

Djankov, S., & Murrell, P. (2002). Enterprise restructuring in transition: A quantitative survey. *Journal of Economic Literature, 40*, 739–792.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *The Academy of Management Review, 14*, 57–74.

Estrin, S., & Prevezer, M. (2011). The role of informal institutions in corporate governance: Brazil, Russia, India, and China compared. *Asia Pacific Journal of Management, 28*, 41–67.

Faccio, M., Lang, L., & Young, L. (2001). Dividends and expropriation. *American Economic Review, 91*, 54–78.

Fama, E., & Jensen, M. (1983). Separation of ownership and control. *Journal of Law and Economics, 26*, 301–325.

Filatotchev, I., Zhang, X., & Piesse, J. (2011). Multiple agency perspective, family control, and private information abuse in an emerging economy. *Asia Pacific Journal of Management, 28*, 69–93.

Gedajlovic, E. R., Lubatkin, M. H., & Schulze, W. S. (2004). Crossing the threshold from founder management to professional management: A governance perspective. *Journal of Management Studies, 41*, 988–1012.

Gomes, A. (2000). Going public without governance: Managerial reputation effects. *Journal of Finance, 55*, 615–646.

Hoskisson, R. E., Eden, L., Lau, C. M., & Wright, M. (2000). Strategy in emerging economies. *Academy of Management Journal, 43*, 249–267.

Hu, H. W., Tam, O. K., & Tan, M. G. (2009). Internal governance mechanisms and firm performance in China. *Asia Pacific Journal of Management, 27*(4), 727–749.

Jensen, M. C. (1993). The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance, 48*, 831–880.

Jensen, M. C., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs, and ownership structure. *Journal of Financial Economics, 3*, 305–350.

Jiang, Y., & Peng, M. W. (2010). Principal-principal conflicts during crisis. *Asia Pacific Journal of Management, 28*(4), 683–695.

Jiang, Y., & Peng, M. W. (2011). Are family ownership and control in large firms good, bad, or irrelevant? *Asia Pacific Journal of Management, 28*, 15–39.

Khanna, T., & Palepu, K. (2000). The future of business groups in emerging markets: Long-run evidence from Chile. *Academy of Management Journal, 43*, 268–285.

Khanna, T., & Rivkin, J. (2001). Estimating the performance effects of business groups in emerging markets. *Strategic Management Journal, 22*, 45–74.

La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1997). Legal determinants of external finance. *Journal of Finance, 52*, 1131–1150.

La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1999). Corporate ownership around the world. *Journal of Finance, 54*, 471–517.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (1998). Law and finance. *Journal of Political Economy, 106*, 1113–1155.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (2000). Investor protection and corporate governance. *Journal of Financial Economics, 58*, 3–27.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (2002). Investor protection and corporate valuation. *Journal of Finance, 57*(3), 1147–1170.

Lins, K. V. (2003). Equity ownership and firm value in emerging markets. *Journal of Financial and Quantitative Analysis, 38*, 159–184.

Lu, J., Xu, B., & Liu, X. (2009). The effects of corporate governance and institutional environments on export behaviour in emerging economies: Evidence from China. *Management International Review, 49*, 455–478.

Morck, R., Wolfenzon, D., & Yeung, B. (2005). Corporate governance, economic entrenchment, and growth. *Journal of Economic Literature, 63*, 655–720.

Morck, R., Yeung, B., & Yu, B. W. (2000). The information content of stock markets: Why do emerging markets have synchronous stock price movements? *Journal of Financial Economics, 58*, 215–260.

Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. *Journal of Financial Economics, 13*(2), 187–221.

North, D. C. (1990). *Institutions, institutional change and economic performance*. New York: Norton.

North, D.C. (1991). Institutions. *Journal of Economic Perspectives*, *5*(1) 97–112.

North, D. C. (1994). Economic performance through time. *American Economic Review, 84*, 359–368.

North, D. C. (2006). *Understanding the process of economic change*. New Delhi: Academic Foundation.

Peng, M. W. (2003). Institutional transitions and strategic choices. *Academy of Management Review, 28*, 275–296.

Peng, M. W. (2004). Outside directors and firm performance during institutional transitions. *Strategic Management Journal, 25*, 453–471.

Peng, M. W., Buck, T., & Filatotchev, I. (2003). Do outside directors and new managers help improve firm performance? An exploratory study in Russian privatization. *Journal of World Business*, *38*(4), 348–360.

Peng, M. W., & Heath, P. (1996). The growth of the firm in planned economies in transition: Institutions, organizations and strategic choice. *Academy of Management Review, 21*, 492–528.

Peng, M. W., & Jiang, Y. (2010). Institutions behind family ownership and control in large firms. *Journal of Management Studies, 47*, 253–273.

Peng, M. W., Lee, S.-H., & Wang, D. (2005). What determines the scope of the firm over time? A focus on institutional relatedness. *Academy of Management Review, 30*, 622–633.

Rajan, R., Servaes, H., & Zingales, L. (2000). The cost of diversity: The diversification discount and inefficient investment. *The Journal of Finance, 55*, 35–80.

Renders, A., & Gaeremynck, A. (2012). Corporate governance, principal-principal agency conflicts, and firm value in European listed companies. *Corporate Governance: An International Review, 18*, 87–106.

Shan, Y. G. (2014). The impact of internal governance mechanisms on audit quality: A study of large listed companies in China. *International Journal of Accounting, Auditing and Performance Evaluation, 10*(1), 68–90.

Smith, A. (1776). *The wealth of nations*. New York: Modern Library.

Stein, J. C. (1997). Internal capital markets and the competition for corporate resources. *The Journal of Finance, 52*, 111–133.

Su, Y., Xu, D., & Phan, P. H. (2008). Principal-principal conflict in the governance of the Chinese public corporation. *Management and Organization Review, 4*, 17–38.

Ward, D., & Filatotchev, I. (2010). Principal–principal–agency relationships and the role of external governance. *Managerial and Decision Economics, 31*, 249–261.

Williamson, O. E. (2000). The new institutional economics: Taking stock, looking ahead. *Journal of Economic Literature, 38*, 595–613.

Xu, X., & Wang, Y. (1999). Ownership structure and corporate governance in Chinese stock companies. *China Economic Review, 10*, 75–98.

Yeung, H. (2006). Change and continuity in Southeast Asian Chinese business. *Asia Pacific Journal of Management, 23*, 229–254.

Yiu, D., Bruton, G. D., & Lu, Y. (2005). Understanding business group performance in an emerging economy: Acquiring resources and capabilities in order to prosper. *Journal of Management Studies, 42*, 183–206.

Young, M., Peng, M. W., Ahlstrom, D., Bruton, G., & Jiang, Y. (2008). Corporate governance in emerging economies: A review of the principal-principal perspective. *Journal of Management Studies, 45*, 196–220.

Zahra, S., & Filatotchev, I. (2004). Governance of the entrepreneurial threshold firm: A knowledge-based perspective. *Journal of Management Studies, 41*, 885–897.

3

Internationalization of Emerging-Market Firms: The Contingent Role of Board Capability

Sandeep Sivakumar, Sreevas Sahasranamam, and Elizabeth L. Rose

Introduction

Research on emerging-market firms has become a key focus in the international business literature in recent times (Khanna & Palepu, 1997, 2004; Mathews, 2006; Ramamurti, 2012). This surge in interest is driven by macro environment changes, the liberalization and reduction of trade

S. Sivakumar (✉)
Indian Institute of Management Kozhikode, Kozhikode, India
e-mail: Sandeeps@protonmail.com

S. Sahasranamam
University of Liverpool, Liverpool, UK
e-mail: mailsreevas@gmail.com

E.L. Rose
University of Otago, Dunedin, New Zealand
Aalto University, Espoo, Finland
Indian Institute of Management Udaipur, Udaipur, India
e-mail: elizabeth.rose@otago.ac.nz

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_3

barriers, rapid international diversification, and increasing prominence of emerging-market firms in many global industries (Gaur & Kumar, 2009; Khanna & Palepu, 2004, 2006). According to recent reports, the outward foreign direct investment from emerging and developing countries is estimated to be $426 billion, a record percentage of the world's total (World Investment Report, 2013, p. 2). Internationalization by emerging-market firms is associated with more risk, uncertainty, and complexity, relative to firms from developed countries (Contractor, Kumar, & Kundu, 2007; Khanna & Palepu, 1997; Khanna & Rivkin, 2001), which requires the presence of board members who exhibit greater tolerance for risk, and who possess the necessary skill sets, market knowledge, and experience to succeed in international markets (Chen, Ho, & Hsu, 2013). Though the literature on the internationalization–performance relationship is growing, research on the role of board of directors in internationalization of emerging-market firms remains relatively scarce (Claessens & Yurtoglu, 2013; Filatotchev, Isachenkova, & Mickiewicz, 2007; Herrmann & Datta, 2005; Wright, Filatotchev, Hoskisson, & Peng, 2005). Macus (2008) noted that the extant research pertaining to the board's influence on performance has focused more on content than on board processes. In an attempt to respond to this research gap, we study the contingent role of the board's capabilities on the relationship between internationalization and performance among emerging-market firms.

Macus (2008) combined content and process research, and argued board interactions, board composition, and board structure to be relevant factors when studying the influence of boards on performance. Macus (2008) defined board capability as consisting of (i) board potential, which represents the abilities of individual directors, including relevant experience, knowledge, and skills pertinent to carrying out the board's various tasks; and (ii) board interaction, which represents the relational dynamics that bring an individual director's problem-solving potential to bear on particular tasks. According to Barroso, Villegas, and Pérez-Calero (2011), board potential depends on five factors: level of academic achievement, international background, industry-specific experience, experience as CEO or general manager, and board tenure.

In an emerging-market context, internationalization is a particularly risky decision because of the uncertain home environment in which firms operate (Contractor et al., 2007). For such risky decision choices, there is long-standing evidence that group decision-making is preferable (Marquis, 1962; Marquis & Reitz, 1969; Stoner, 1968). This makes it important to look not only at the potential of the board, but also at the interactions among the board members, which lead to group decision-making. Therefore, we develop a conceptual model proposing the contingent effect of these board capability variables on the relationship between internationalization and performance for emerging-market firms.

The remainder of this chapter is structured as follows. In the next section, we provide a literature review covering the internationalization–performance relationship, along with contextual moderators of this relationship, with specific focus on the role of board characteristics. We also provide background into the internationalization of emerging-market firms. In the subsequent section, we develop the propositions arguing the contingent effect of board capability on the relationship between internationalization and performance in emerging-market firms. Finally, we conclude the paper with suggested directions for future research.

Literature Review

According to Bausch and Krist (2007), after 30 years of research effort, the nature of the relationship between internationalization and performance remains inconclusive, and researchers have not yet reached a consensus; this heterogeneity in empirical results has led to differing views and conclusions. According to Gaur and Kumar (2009), the extant research can be classified into three broad categories: (i) studies focusing primarily on establishing the internationalization–performance relationship without considering contextual or moderating factors, (ii) studies focusing primarily on the influence of moderating factors on internationalization–performance relationship, and (iii) studies focusing primarily on the internationalization–performance relationship in various institutional, industrial, and cultural settings.

Baush and Krist (2007) conducted a meta-analytical study on research work published in leading international business journals spanning a 30-year period, and concluded that the relationship between internationalization and performance is context-dependent. According to Hamel and Prahalad (1996), the advent of new technologies, de-regulation of markets, globalization, and the thinning of national boundaries have all led to previously unexpected competitors, and increased rivalry from global rivals. Many studies have identified internationalization as a strategic response to these developments, aimed at generating opportunities for firm growth (Hitt, Hoskisson, & Ireland, 1994; Hitt, Hoskisson, & Kim, 1997). However, the target countries for internationalization present several challenges, due to differences in external environments. Pressures from the external environment tend to propel strategic change, and several of the reviewed studies mention the role of the board of directors in triggering such changes (Grinyer & McKiernan, 1990).

Effect of Board Characteristics

Deutsch (2005) noted that board's role and influence on firm performance has long been an important line of research. For example, many proponents of resource dependency theory identify the firm's board of directors as an important mechanism through which the organization responds to environmental uncertainties (e.g., Baysinger & Hoskisson, 1990; Boyd, 1990; Goodstein, Gautam, & Boeker, 1994; Pfeffer, 1972, 1973). Pearce and Zahra (1992) argued that input from the board will be crucial in situations in which the firm's executives have limited prior information or experience regarding strategies and competitors in a new market. Zahra and Pearce (1989, 1990) identified that boards of directors influence the overall strategy of a firm by interlinking with stakeholders, control, and strategy formulation. The findings from the extant research lead to the conclusion that the nature and character of companies are strongly affected by the effectiveness of their boards (Barroso, Villegas, & Pérez-Calero, 2011). As noted earlier, the ongoing globalization and rapid changes in the business landscape mean that a firm's internationalization strategy is crucial. Under such circumstances, the effectiveness of the board in making appropriate strategic decisions is a key element in the development and sustainability of competitive advantage (Barney, 1991; Barroso et al., 2011). Sanders and Carpenter (1998) described the board of directors as a key mechanism by which a firm responds to the complexities of a new market. Though the importance of a board of directors that understands the logic and dynamics of foreign markets has been discussed extensively in the literature, the board's influence on internationalization–performance relationship has found limited attention (Barroso et al., 2011; Herrmann & Datta, 2005; Luo, 2005). This chapter attempts to address this gap by extending the extant literature on board characteristics, and linking it to the internationalization and performance of emerging-market firms.

As mentioned earlier, the board has three major roles to perform: control, service/collaboration, and provision of key resources (Johnson, Daily, & Ellstrand, 1996; Zahra & Pearce, 1990). The extant corporate governance and international business literatures have analyzed these three roles independently, under various theoretical perspectives. The role of the board as control mechanism is generally explored using agency theory (e.g., Langevoort, 2001; Sundaramurthy & Lewis, 2003). The board of directors' service role has been investigated using the lens of stewardship theory (e.g., Donaldson, 1990), and the resource dependency perspective informs the board's role as a provider of resources, information, and protection (e.g., Pfeffer, 1972, 1973; Pfeffer & Salancik, 2003). More recently, arguments based on resource dependency theory have been further extended, through contributions from the social network perspective (e.g., Carpenter & Westphal, 2001; Westphal, 1999).

In a theoretical model, Hillman and Dalziel (2003) coined the term, "board capital", combining both the relational and the human capital perspectives, and argued that, to be effective, the board needs motivation, as well as ability in the form of relevant experience, knowledge, and skills. Forbes and Milliken (1999) brought a broader view of the board's influence by studying its human capital, conceptualizing the board as a social system with idiosyncratic characteristics. In this framework, the board's effectiveness depends on psychosocial processes at every decision-making step. This study is in contrast with other studies (e.g., Finkelstein & Hambrick, 1996; Pettigrew, 2008) that treated boards as "black boxes" and related board demography to company performance.

According to Kor and Sundaramurthy (2008), the resource-based view (RBV) provides a theoretical perspective that is helpful in explaining how the attributes that the directors bring to the firm are used, and provides an explanation for how the board's resources are integrated with the firm's internal processes. The RBV suggests that sustainable competitive advantage results from the integration of resources in a unique way, which is inimitable by competitors (e.g., Barney, 1991; Eisenhardt & Martin, 2000, Wernerfelt, 1984). In this perspective, the resources that the board of directors brings can be considered as a part of the firm's intangible resource base and offer the potential to form the basis of sustainable competitive advantage. According to Macus (2008), understanding the board's capability requires that relational dynamics be understood in the broadest sense, including the dynamics among the directors, between the directors and firm management, and between the directors and external constituencies. Macus (2008) argued that board interactions represent an enabling factor that allows the board to realize its problem-solving potential and thus to contribute toward the firm's performance. It is worth noting that the idea that board interaction is a determinant of its problem-solving potential is closely related to the concept of capability in the RBV (Macus, 2008).

According to Barroso et al. (2011), the extant literature on board influence on the internationalization–performance relationship can be classified into two categories: the influence of the board's demographic characteristics on internationalization (e.g., Sanders & Carpenter, 1998; Zahra, Neubaum, & Naldi, 2007), and the board's effectiveness at working within an international context (e.g., Gabrielsson, 2007; Ward & Feldman, 2008). However, few studies specify the role of board capability or potential, which leaves room for detailed investigation into how the board's capability affects the relationship between internationalization and performance (Contractor et al., 2007; Lu & Beamish, 2006).

Internationalization of Emerging-Market Firms

The internationalization patterns of emerging-market firms are generally different from those of developed-market firms, due to many idiosyncratic characteristics unique to emerging markets (Hoskisson, Kim, White, & Tihanyi, 2004). Many of the prominent theoretical perspectives of internationalization, such as Dunning's Eclectic Paradigm (Ownership–Location–Internationalization) framework (Dunning, 2000), were developed based on the activities of developed-market multinational enterprises (MNEs). A key distinction is that developed-market firms are likely to have enjoyed the opportunity of market share and broad access to resources prior to their internationalization, whereas emerging-market firms are more likely to have internationalized in order to strengthen their position in both the home and foreign markets (Gaur & Kumar, 2009; Ramamurti, 2012). Many studies report that institutional and other contextual factors make internationalization from emerging markets quite different from that of developed markets (e.g., Mathews, 2006; Ramamurti, 2012). Firms from emerging markets are often small, resource-deficient, have less experienced top-management, and thus have greater need for both legitimacy and resources (Contractor et al., 2007; Ramamurti, 2012). According to Ramamurti (2012), the internationalization of developed-country MNEs is driven by the expectation that internationalization will expand their firm-specific assets (Rugman, 1981), whereas many emerging-market multinationals do not have sustainable firm-specific assets, and thrive, instead, on competencies that they have developed in the home market.

As indicated earlier, different institutional, cultural, and industrial settings in emerging markets act as drivers of internationalization. Emerging-market firms often choose to internationalize in order to overcome home-country disadvantages that are caused by institutional voids and a lack of government support (Child & Rodrigues, 2005). The domestic markets of many emerging-market firms are still characterized by weak institutions and uncertainties that result from suboptimal institutional support for market-based transactions (Choi, Lee, & Kim, 1999; Peng, 2003). The uncertainties associated with the home market also act as drivers for the internationalization of emerging-market firms. Sinha (2005) noted that emerging-market firms develop unique competencies because of their experience of operating in a weak institutional context, characterized by underdeveloped infrastructure to facilitate distribution, and with serving demanding and price-sensitive customers; these competencies are viewed as helping these firms to internationalize.

Development of Propositions

Internationalization–Performance Relationship in Emerging-Market Firms

The extant literature has identified three stages of internationalization, namely early, growth, and mature. The early stage is characterized by the need to operate in an unfamiliar environment, with high costs associated with learning, coordination, and set-up. The unfamiliar environment increases transaction and learning costs, as the firm has to spend considerable time to understand, acquire, and assimilate local knowledge, culture, and market requirements (Gaur & Lu, 2007). Hitt et al. (1997) reason that the lack of managerial expertise and experience further attenuates the cost of operation during the initial internationalization phase. Legitimacy pressures also create major challenges for a typical emerging-market firm, due to its weak country of origin when entering foreign markets (Gaur & Lu, 2007).

Mathews (2006) argued that the very rapid internationalization of emerging-market firms from the Asia-Pacific region was quite different from their western, developed-market counterparts, and credited this accelerated internationalization to organizational and strategic innovations. This rapid internationalization marked the transition of emerging-market firms from the early stage to the growth stage (Khanna & Palepu, 2004, 2006), which is characterized by the flattening of the downward-sloping curve between internationalization and performance posited in the early stage, as the firm's investment starts to accrue (Contractor et al., 2007). Careful initial investment during the early stage of internationalization pays off during the rapid geographic expansion of the growth stage. The various benefits that accrue during the growth stage include the exploitation of proprietary firm-specific assets developed during the early stage (Buckley, 1988; Caves, 1996; Delios & Beamish, 2001), global economies of scale and scope (Caves, 1971; Hymer, 1976), accumulated market power and knowledge (Kogut, 1985), and greater opportunities to exploit market imperfections (Caves, 1971). According to Gaur and Kumar (2009), emerging-market firms do not possess firm-specific advantages comparable to those of their developed market counterparts. This may prompt emerging-market firms to internationalize into other emerging markets that have similar resource and institutional conditions, which may lead to better resource utilization, relative to their developed-market counterparts expanding into emerging markets. These scholars further noted that when an emerging-market firm internationalizes into a developed economy with better institutional infrastructure, the experience helps the firm to develop new capabilities and resources that may not be possible in an emerging market.

Gradually, some of the incremental benefits that have accrued to the internationalizing firms begin to fade away, due to the increased cost of global operations and coordination costs of working between geographies; this marks the mature stage of internationalization (Contractor, Kundu, & Hsu, 2003). The increased costs at the maturity stage may be due to greater geographical scope (Grant, 1987), informational overload (Hitt et al., 1997), cultural and institutional diversity (Ghoshal & Bartlett, 1990; Sundaram & Black, 1992), and escalated monitoring problems due to rent-seeking behaviors of subsidiary managers (Gaur, Delios, & Singh, 2007). However, according to Mathews (2006), these costs may be of less concern for firms from emerging markets at present. As they have tended to internationalize later, and are more likely to find themselves in the early or growth stages, few will find themselves "over-internationalized" to the point of affecting the internationalization–performance relationship (Contractor et al., 2007; Gaur & Kumar, 2009). On this basis, we focus on the early or growth stage of internationalization, which we expect to be characterized by an initial downward slope in the relationship between internationalization and performance, followed by an upward slope, yielding a U-shaped curve. Thus, we propose:

Proposition 1 The relationship between internationalization and performance for emerging-market firms will be U-shaped, with a downward slope during early phase followed by an upward slope during the growth phase.

Board Capability as a Moderator of the Internationalization–Performance Relationship

As defined earlier, board capability is a combination of the board's potential and its interaction. Extant research suggests that the intangible resources that directors bring, such as experience, skills, and expertise (board potential), along with the relational dynamics (board interaction), act as enablers for the board's problem-solving potential (Kor & Sundaramurthy, 2008; Macus, 2008). According to the RBV, the possession of resources that are valuable, rare, inimitable, and non-substitutable provide the basis for developing capabilities that distinguish firms from one another (Barney, 1991). It follows, then, that the board of directors brings intangible resources to the firm that when integrated in unique ways, contribute to superior firm performance. According to Barroso et al. (2011), different boards bring various intangible resources, and the heterogeneous distribution of these resources among firms, along with the fact that resources vary in their level of criticality to particular firms, means that board potential such as skills, experience, and expertise are crucial elements of creating unique competitive advantage.

Board potential is the ability of the board members to contribute towards the development of sustainable competitive advantage by virtue of their personal and professional qualities. According to Pearce and Zahra (1992), board composition and size will be crucial in situations in which the firm's executives have little prior information about, or experience with, strategies and competitors in a new market. In the initial phase of internationalization, when emerging-market firms are expanding into new and unfamiliar foreign environments, they incur substantial learning, coordination and set-up costs that may, for some time, exceed the benefits of internationalization (Contractor et al., 2007). Internationalization is associated with considerable challenges and threats, and may expose firms to organizational problems such as coordination difficulties, incentive misalignment, and information asymmetry between subsidiaries and headquarters, and increased monitoring costs (Hymer, 1976; Lu & Beamish, 2006). In order to tackle the associated complexity, boards need particular attributes and skill sets, to support effective decision-making in the new environment (Pearce & Zahra, 1992). Westphal (1999) argued that industry-specific experience shapes directors' thinking, frames of reference, and perceptions, and is crucial to acquiring industry-specific knowledge and skills that are essential for strategic decision-making.

George, Wiklund, and Zahra (2005) emphasized the role of board interaction, noting that internationalization is a complex and costly process that demands the participation and collaboration of the entire top-management group, to investigate opportunities thoroughly, build the infrastructure necessary for international expansion, and develop and execute multiple strategies. In the emerging-market context, internationalization is a risky decision because of the uncertain environment into which the firms enter and the limited resources they have at their disposal (Contractor et al., 2007). The literature suggests that riskier strategic choices are more likely to emerge from group decision-making, rather than at the individual level (Marquis, 1962; Marquis & Reitz, 1969; Stoner, 1968). Hence, in emerging-market firms, the risky decision to pursue internationalization may be more likely to result from board members' group decision-making. Therefore, it is important to look not only at the potential of individual board members, but also at the interactions among the board members that lead to group-level decisions. This emphasizes the importance of considering both board's potential and its interactions, in order to understand its influence on the internationalization–performance relationship in emerging-market firms. We suggest a model of this process, shown as Fig. 3.1, based on six propositions described in the following sections.

Board Potential

As noted earlier, board potential is defined "as the ability of an individual director such as relevant experience, knowledge and skills in carrying out the various board's tasks" (Barroso et al., 2011: 353). We develop propositions pertaining to each of the five elements of board potential (tenure, top-management experience, industry-specific experience, academic achievement, and international background), with respect to their effect on the internationalization–performance relationship for emerging-market firms in this section.

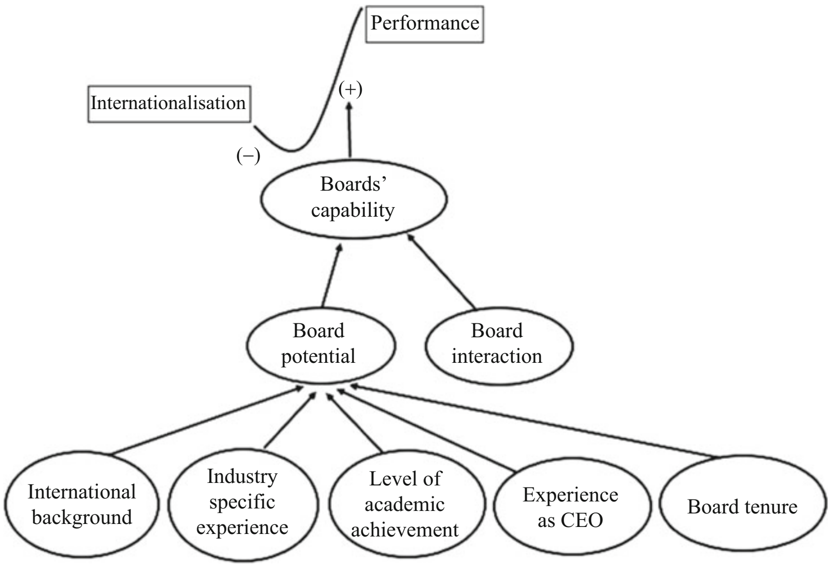


Fig. 3.1 Proposed model

Board Tenure

The general assumption that a board member's knowledge increases with tenure leads to the expectation that longer tenure brings more value to the firm (Chen, 2011). On the other hand, Barroso et al. (2011) extend the RBV arguments of causal ambiguity, bounded rationality, and routines from the context of managers to boards, to make the case for a negative effect of board tenure. Barney (1991) argued that causal ambiguity precludes managers from fully understanding the link between firm resources and competitive advantage. Causal ambiguity thus makes the imitation of key intangible strategic resources very difficult for a competing firm (Barney, 1991). Hence, extending the argument of RBV proponents, it is suggested that long tenure may not increase board member's knowledge because they never fully understand their resources. In a similar vein, Nelson and Winter (1982) suggested that bounded rationality limits managers to previously learned patterns of actions called "routines", which are formed slowly, and are derived from past experiences. These routines may lead to problems of myopia, which tend to reinforce past behaviors (Levinthal & March, 1993). Similarly, Golden and Zajac (2001) argued that boards with long-serving members tend to be rigid and averse to strategic change, making them reluctant to explore risky strategies such as internationalization. Boone, Van Olffen, Van Witteloostuijn, and De Brabander (2004) also argued that long tenures create a homosocial, less diverse board, which has a negative impact on the quality of decision-making. In a study carried out in the emerging-market context of Turkey, Kaymak and Bektas (2008) noted that, because it can be difficult to hold long-serving members of the board accountable for underperforming, long board tenures can damage the quality of the board's decisions.

These arguments suggest that long tenure among board members has limited value as a strategic resource. Since the internationalization of emerging-market firms is associated with uncertainty and complexity (Contractor et al., 2007; Hoskisson et al., 2004), we propose that the rigidity and routine decision-making associated with long-serving board members has a negative moderating effect on the relationship between internationalization and performance.

Proposition 2a Board members' tenure negatively moderates the relationship between internationalization and performance for emerging-market firms, such that high level of board member tenure is associated with decreased performance attributable to internationalization.

Experience as CEO or General Manager

According to Rindova (1999), board members' top-management (CEO or general manager) experiences represent an important resource that contributes to strategic problem-solving and decision-making skills. From the RBV perspective, Barney (1991) argued that previous experience as CEO provides board members with the inimitable resource of tacit knowledge, which can be uniquely integrated with intangible resources, such as board members' expertise, experience, and skills, to create competitive advantage for the firm. Jaw and Lin (2009) noted that company CEOs are influential members in a business environment, with the capability of developing long-lasting relationships among corporate elites, which grants them access to a wide range of powerful individuals and organizations. In an emerging-market context, Xie (2014) argued that CEOs with less experience are likely to be risk-averse, preferring lower risk strategies due to their limited knowledge, while those with more experience enjoy greater power and play a key role in making higher risk strategic decisions; this is due to experienced CEOs' having more tacit knowledge and enjoying greater autonomy and power, which allows them to be more confident in leading firms to undertake resource-intensive and high-risk strategies.

Thus, from an RBV perspective, previous top-management experience provides board members with a broad range of strategic skills and network resources; these are inimitable and rare, which can lead to the formation of competitive advantage. During internationalization, the performance of firms, especially those from emerging markets, depends on their ability to cope with complex and heterogeneous cultural, institutional, and competitive environments (Ricks, Toyne, & Martinez, 1990). We argue that board members' prior experience as CEOs or general managers will act as a rare and inimitable resource, and propose:

Proposition 2b Board members' experience as CEOs or general managers positively moderates the relationship between internationalization and performance in emerging-market firms, such that high level of board member experience is associated with increased performance attributable to internationalization.

Industry-Specific Experience

The business environment faced by an internationalized firm is complex and difficult in terms of decision-making (e.g., Prahalad, 1990; Zahra & Pearce, 1990). According to Carpenter and Westphal (2001), the evaluation of strategic decisions is often made on the basis of insights derived from the firm's current environment. Under these circumstances, directors' industry-specific experience plays a crucial role with respect to the board's ability to advise management on international strategic decisions. Castanias and Helfat (2001) noted that such industry-specific experience offers additional benefits, such as spotting emerging trends in an industry, and improves the ability of the board to better appraise strategies for growth. Similarly, Kor and Sundaramurthy (2008) noted that the industry-specific experience of board members can yield goodwill and connections with various industry participants, which can assist the firm to acquire key resources for international growth. Hence, from the RBV perspective, we propose that:

Proposition 2c Board members' industry-specific experience positively moderates the relationship between internationalization and performance in emerging-market firms, such that high level of board member industry-specific experience is associated with increased performance attributable to internationalization.

International Backgrounds of Board Members

Zahra et al. (2007) argued that board members with relevant experience in international markets can play useful supporting roles in decision-making processes regarding international opportunities, by virtue of their networks and connections. Arguing from the RBV perspective, Barney (1991) conceptualized such international backgrounds as tacit knowledge, representing a valuable and inimitable resource. Sambharya (1996) argued that heterogeneity of experience and the presence of managers with foreign experience aids in the internationalization of firms. According to Barroso et al. (2011), directors with international education backgrounds are likely to be more open-minded toward various cultures and, in turn, improve the human capital of the firm; this also represents a valuable, and potentially rare, resource. Since emerging-market firms traditionally have limited exposure to operating in international markets (Elango & Pattnaik, 2007), we propose that the presence of board members having such international exposure will be beneficial:

Proposition 2d Board members' international backgrounds positively moderate the relationship between internationalization and performance in emerging-market firms, such that high level of board member international background is associated with increased performance attributable to internationalization.

Academic Achievement

Researchers have pointed out the importance of board members' education levels for the overall performance of the firm (e.g., Bennett & Robson, 2004; Chen et al., 2013; Kirby, 1990). With education comes additional skills and knowledge, and this increases the capacity for better decision-making (Hsu, Chen, & Cheng, 2013). The academic achievement of board of directors facilitates greater participation in international decisions, and more readiness to use external information (Crabtree & Gomolka, 1991). Also, education is associated with stronger receptivity to innovation and tolerance for ambiguity. When operating in unfamiliar international markets, the education level of board members can thus act as a valuable resource for dealing with ambiguous situations (Goll, Brown Johnson, & Rasheed, 2007). Hence, consistent with the RBV, we propose that:

Proposition 2e Board members' level of academic achievement positively moderates the relationship between internationalization and performance in emerging-market firms, such that high level of board member academic achievement is associated with increased performance attributable to internationalization.

Board Interactions

As discussed earlier, Macus (2008) argued that the notion of relational dynamics informs an understanding of the board's capabilities; this includes the dynamics among the directors, between the directors and firm management, and between the directors and external constituencies. There are substantial risks for emerging-market firms, associated with making the internationalization decision, considering the uncertain environment in which they operate (Contractor et al., 2007). For such risky decision choices, scholars argue that group decision-making is preferable (Marquis, 1962; Marquis & Reitz, 1969; Stoner, 1968). Such group decisions are dependent on the relational dynamics between board members, and consensus needs to be reached between them for taking risky decisions. Forbes and Milliken (1999) argued that a board's effectiveness depends not only on its ability to perform its tasks, but also on its ability to work together.

Building on this argument, we suggest that, along with the board's potential, its cohesiveness as a group is an important factor, as this includes a consideration of the group's psychosocial process in the context of decision-making. As the challenges posed by an international market require timely and effective decision-making, board cohesiveness should have a key role in attaining international performance. However, Forbes and Milliken (1999) noted that high levels of cohesiveness may prove detrimental to the quality of decision-making, as such boards may be distracted by personal exchanges and biases. Mullen, Anthony, Salas, and Driskell (1994) identified cohesiveness as an antecedent to group-think, which is a dysfunctional mode of decision-making characterized by a lack of critical thinking and overemphasis on unanimity among members. However, they also argue that cohesiveness will only result in group-think in the absence of cognitive conflict among members. According to Janis (1982), cognitive conflict in a group helps in preventing the emergence of group-think by cultivating an environment characterized by task-oriented focus and acceptance of multiple viewpoints. On this basis, we propose that moderate levels of interaction among board members are likely to enhance the internationalization–performance relationship of emerging-market firms.

Proposition 2f Board interaction has an inverted U-shaped moderating effect on the relationship between internationalization and performance in emerging-market firms, such that the strength of the relationship increases for low-to-moderate levels of board interaction and decreases for moderate-to-high levels.

Conclusion

The internationalization of emerging-market firms is a relatively new phenomenon, and it is associated with considerable risk, high levels of uncertainty, and complexity (Contractor et al., 2007; Khanna & Palepu, 1997). These characteristics demand a board of directors that exhibits a generous tolerance for risk, and whose members possess the necessary skill sets, market knowledge, and experience to succeed in international markets (Chen et al., 2013). Though the literature on the internationalization–performance relationship is increasing, research pertaining to board members' roles in international diversification remains scarce (Herrmann & Datta, 2005; Claessens & Yurtoglu, 2013). We have built on the RBV perspective to highlight the contingent role of the board's capabilities on the internationalization–performance relationship for emerging-market firms. We propose that board tenure will inhibit the positive effects of internationalization on performance, whereas board members' top-level managerial experiences, industry-specific experiences, international experiences, and levels of academic achievement will enhance the positive effects of internationalization on performance. In addition, we argue that the nature of the board's interactions is crucial to decision-making pertaining to emerging-market firm internationalization, and propose that moderate levels of board interaction will enhance the positive effects of internationalization on performance. Future research is needed to explore the board interaction dimension in detail, especially in the emerging-market context, understanding its effect on different strategic choices of the firms.

References

Barney, J. (1991). Firm resources and sustained competitive advantage. *Journal of Management, 17*(1), 99–120.

Barroso, C., Villegas, M. M., & Pérez-Calero, L. (2011). Board influence on a firm's internationalization. *Corporate Governance: An International Review, 19*(4), 351–367.

Bausch, A., & Krist, M. (2007). The effect of context-related moderators on the internationalization-performance relationship: Evidence from meta-analysis. *Management International Review, 47*(3), 319–347.

Baysinger, B., & Hoskisson, R. E. (1990). The composition of boards of directors and strategic control: Effects on corporate strategy. *Academy of Management Review, 15*(1), 72–87.

Bennett, R. J., & Robson, P. J. A. (2004). The role of boards of directors in small and medium-sized firms. *Journal of Small Business and Enterprise Development, 11*(1), 95–113.

Boone, C., Van Olffen, W., Van Witteloostuijn, A., & De Brabander, B. (2004). The genesis of top management team diversity: Selective turnover among top management teams in Dutch newspaper publishing, 1970–94. *Academy of Management Journal, 47*(5), 633–656.

Boyd, B. (1990). Corporate linkages and organizational environment: A test of the resource dependence model. *Strategic Management Journal, 11*(6), 419–430.

Buckley, P. J. (1988). The limits of explanation: Testing the internalization theory of the multinational enterprise. *Journal of International Business Studies, 19*(2), 181–193.

Carpenter, M. A., & Westphal, J. D. (2001). The strategic context of external network ties: Examining the impact of director appointments on board involvement in strategic decision making. *Academy of Management Journal, 44*(4), 639–660.

Castanias, R. P., & Helfat, C. E. (2001). The managerial rents model: Theory and empirical analysis. *Journal of Management, 27*(6), 661–678.

Caves, R. E. (1971). International corporations: The industrial economics of foreign investment. *Economica, 38*(149), 1–27.

Caves, R. E. (1996). *Multinational enterprise and economic analysis*. Cambridge, UK: Cambridge University Press.

Chen, H.-L. (2011). Does board independence influence the top management team? Evidence from strategic decisions toward internationalization. *Corporate Governance: An International Review, 19*(4), 334–350.

Chen, H.-L., Ho, M. H.-C., & Hsu, W.-T. (2013). Does board social capital influence chief executive officers' investment decisions in research and development? *R&D Management, 43*(4), 381–393.

Child, J., & Rodrigues, S. B. (2005). The internationalization of Chinese firms: A case for theoretical extension. *Management and Organization Review, 1*(3), 381–410.

Choi, C. J., Lee, S. H., & Kim, J. B. (1999). A note on countertrade: Contractual uncertainty and transaction governance in emerging economies. *Journal of International Business Studies, 30*(1), 189–201.

Claessens, S., & Yurtoglu, B. B. (2013). Corporate governance in emerging markets: A survey. *Emerging Markets Review, 15*, 1–33.
Contractor, F. J., Kumar, V., & Kundu, S. K. (2007). Nature of the relationship between international expansion and performance: The case of emerging market firms. *Journal of World Business, 42*(4), 401–417.
Contractor, F. J., Kundu, S. K., & Hsu, C.-C. (2003). A three-stage theory of international expansion: The link between multinationality and performance in the service sector. *Journal of International Business Studies, 34*(1), 5–18.
Crabtree, R. G., & Gomolka, E. G. (1991). Perceptual barriers to consultant utilization: An examination of why manufacturers don't use consultants and what consultants can do about it. In D. Bensch & J. Mugler (Eds.), *Proceedings of the International Council for Small Business* (pp. 76–84). Vienna: ICSB World Conference.
Delios, A., & Beamish, P. W. (2001). Geographic scope, product diversification and the corporate performance of Japanese firms. *Japanese Subsidiaries in the New Global Economy, 20*(8), 711–727.
Deutsch, Y. (2005). The impact of board composition on firms' critical decisions: A meta-analytic review. *Journal of Management, 31*(3), 424–444.
Donaldson, L. (1990). The ethereal hand: Organizational economics and management theory. *Academy of Management Review, 15*(3), 369–381.
Dunning, J. H. (2000). The eclectic paradigm as an envelope for economic and business theories of MNE activity. *International Business Review, 9*(2), 163–190.
Eisenhardt, K. M., & Martin, J. A. (2000). Dynamic capabilities: What are they? *Strategic Management Journal, 21*(10–11), 1105–1121.
Elango, B., & Pattnaik, C. (2007). Building capabilities for international operations through networks: A study of Indian firms. *Journal of International Business Studies, 38*(4), 541–555.
Filatotchev, I., Isachenkova, N., & Mickiewicz, T. (2007). Corporate governance, managers' independence, exporting, and performance of firms in transition economies. *Emerging Markets Finance and Trade, 43*(5), 62–77.
Finkelstein, S., & Hambrick, D. C. (1996). *Strategic leadership: Top executives and their effects on organizations*. Minneapolis, MN: South-Western Publishing.
Forbes, D. P., & Milliken, F. J. (1999). Cognition and corporate governance: Understanding boards of directors as strategic decision-making groups. *Academy of Management Review, 24*(3), 489–505.

Gabrielsson, J. (2007). Boards of directors and entrepreneurial posture in medium-size companies: Putting the board demography approach to a test. *International Small Business Journal, 25*(5), 511–537.

Gaur, A. S., Delios, A., & Singh, K. (2007). Institutional environments, staffing strategies, and subsidiary performance. *Journal of Management, 33*(4), 611–636.

Gaur, A. S., & Kumar, V. (2009). International diversification, business group affiliation and firm performance: Empirical evidence from India. *British Journal of Management, 20*(2), 172–186.

Gaur, A. S., & Lu, J. W. (2007). Ownership strategies and survival of foreign subsidiaries: Impacts of institutional distance and experience. *Journal of Management, 33*(1), 84–110.

George, G., Wiklund, J., & Zahra, S. A. (2005). Ownership and the internationalization of small firms. *Journal of Management, 31*(2), 210–233.

Ghoshal, S., & Bartlett, C. A. (1990). The multinational corporation as an inter-organizational network. *Academy of Management Review, 15*(4), 603–626.

Golden, B. R., & Zajac, E. J. (2001). When will boards influence strategy? Inclination x power = strategic change. *Strategic Management Journal, 22*(12), 1087–1111.

Goll, I., Brown Johnson, N., & Rasheed, A. A. (2007). Knowledge capability, strategic change, and firm performance: The moderating role of the environment. *Management Decision, 45*(2), 161–179.

Goodstein, J., Gautam, K., & Boeker, W. (1994). The effects of board size and diversity on strategic change. *Strategic Management Journal, 15*(3), 241–250.

Grant, R. M. (1987). Multinationality and performance among British manufacturing companies. *Journal of International Business Studies, 18*(3), 79–89.

Grinyer, P., & McKiernan, P. (1990). Generating major change in stagnating companies. *Strategic Management Journal, 11*(4), 131–146.

Hamel, G., & Prahalad, C. K. (1996). Competing in the new economy: Managing out of bounds. *Strategic Management Journal, 17*(3), 237–242.

Herrmann, P., & Datta, D. K. (2005). Relationships between top management team characteristics and international diversification: An empirical investigation. *British Journal of Management, 16*(1), 69–78.

Hillman, A. J., & Dalziel, T. (2003). Boards of directors and firm performance: Integrating agency and resource dependence perspectives. *Academy of Management Review, 28*(3), 383–396.

Hitt, M. A., Hoskisson, R. E., & Ireland, R. D. (1994). A mid-range theory of the interactive effects of international and product diversification on innovation and performance. *Journal of Management, 20*(2), 297–326.

Hitt, M. A., Hoskisson, R. E., & Kim, H. (1997). International diversification: Effects on innovation and firm performance in product-diversified firms. *Academy of Management Journal, 40*(4), 767–798.

Hoskisson, R. E., Kim, H., White, R. E., & Tihanyi, L. (2004). A framework for understanding international diversification by business groups from emerging economies. *Advances in International Management, 16*, 137–163.

Hsu, W.-T., Chen, H.-L., & Cheng, C.-Y. (2013). Internationalization and firm performance of SMEs: The moderating effects of CEO attributes. *Journal of World Business, 48*(1), 1–12.

Hymer, S. H. (1976). *The international operations of national firms: A study of direct foreign investment*. Cambridge, MA: MIT Press.

Janis, I. L. (1982). *Groupthink: Psychological studies of policy decisions and fiascos*. Boston, MA: Houghton Mifflin.

Jaw, Y.-L., & Lin, W.-T. (2009). Corporate elite characteristics and firm's internationalization: CEO-level and TMT-level roles. *International Journal of Human Resource Management, 20*(1), 220–233.

Johnson, J. L., Daily, C. M., & Ellstrand, A. E. (1996). Boards of directors: A review and research agenda. *Journal of Management, 22*(3), 409–438.

Kaymak, T., & Bektas, E. (2008). East meets west? Board characteristics in an emerging market: Evidence from Turkish banks. *Corporate Governance: An International Review, 16*(6), 550–561.

Khanna, T., & Palepu, K. (1997). Why focused strategies may be wrong for emerging markets. *Harvard Business Review, 75*(4), 41–58.

Khanna, T., & Palepu, K. G. (2004). Globalization and convergence in corporate governance: Evidence from Infosys and the Indian software industry. *Journal of International Business Studies, 35*(6), 484–507.

Khanna, T., & Palepu, K. G. (2006). Emerging giants: Building world-class companies in developing countries. *Harvard Business Review, 84*(10), 60–69.

Khanna, T., & Rivkin, J. W. (2001). Estimating the performance effects of business groups in emerging markets. *Strategic Management Journal, 22*(1), 45–74.

Kirby, D. A. (1990). Management education and small business development: An exploratory study of small firms in the UK. *Journal of Small Business Management, 28*(4), 78–87.

Kogut, B. (1985). Designing global strategies: Comparative and competitive value added chains. *Sloan Management Review, 26*(4), 15–28.
Kor, Y. Y., & Sundaramurthy, C. (2008). Experience-based human capital and social capital of outside directors. *Journal of Management, 35*(4), 981–1006.
Langevoort, D. C. (2001). The human nature of corporate boards: Law, norms, and the unintended consequences of independence and accountability. *Georgetown Law Journal, 89*(4), 797–832.
Levinthal, D. A., & March, J. G. (1993). The myopia of learning. *Strategic Management Journal, 14*(S2), 95–112.
Lu, J. W., & Beamish, P. W. (2006). SME internationalization and performance: Growth vs. profitability. *Journal of International Entrepreneurship, 4*(1), 27–48.
Luo, Y. (2005). How does globalization affect corporate governance and accountability? A perspective from MNEs. *Journal of International Management, 11*(1), 19–41.
Macus, M. (2008). Board capability: An interactions perspective on boards of directors and firm performance. *International Studies of Management & Organization, 38*(3), 98–116.
Marquis, D. G. (1962). Individual responsibility and group decisions involving risk. *Industrial Management Review, 3*(2), 8–23.
Marquis, D. G., & Reitz, H. J. (1969). Effect of uncertainty on risk taking in individual and group decisions. *Behavioral Science, 14*(4), 281–288.
Mathews, J. A. (2006). Dragon multinationals: New players in 21st century globalization. *Asia Pacific Journal of Management, 23*(1), 5–27.
Mullen, B., Anthony, T., Salas, E., & Driskell, J. E. (1994). Group cohesiveness and quality of decision making an integration of tests of the groupthink hypothesis. *Small Group Research, 25*(2), 189–204.
Nelson, R. R., & Winter, S. G. (1982). *An evolutionary theory of economic change*. Cambridge, MA: Belknap.
Pearce, J. A., & Zahra, S. A. (1992). Board composition from a strategic contingency perspective. *Journal of Management Studies, 29*(4), 411–438.
Peng, M. W. (2003). Institutional transitions and strategic choices. *Academy of Management Review, 28*(2), 275–296.
Pettigrew, A. M. (2008). On studying managerial elites. *Strategic Management Journal, 13*(S2), 163–182.
Pfeffer, J., & Salancik, G. R. (2003). *The external control of organizations: A resource dependence perspective*. Stanford, CA: Stanford Business Books.

Pfeffer, J. S. (1972). Size and composition of corporate boards of directors: The organization and its environment. *Administrative Science Quarterly, 17*(2), 218–228.

Pfeffer, J. S. (1973). Size, composition, and function of hospital boards of directors: A study of organization-environment linkage. *Administrative Science Quarterly, 18*(3), 349–364.

Prahalad, C. K. (1990). Globalization: The intellectual and managerial challenges. *Human Resource Management, 29*(1), 27–37.

Ramamurti, R. (2012). What is really different about emerging market multinationals? *Global Strategy Journal, 2*(1), 41–47.

Ricks, D. A., Toyne, B., & Martinez, Z. (1990). Recent developments in international management research. *Journal of Management, 16*(2), 219–253.

Rindova, V. P. (1999). What corporate boards have to do with strategy: A cognitive perspective. *Journal of Management Studies, 36*(7), 953–975.

Rugman, A. M. (1981). *Inside the multinationals: The economics of internal markets*. New York: Columbia University Press.

Sambharya, R. B. (1996). Foreign experience of top management teams and international diversification strategies of US multinational corporations. *Strategic Management Journal, 17*(9), 739–746.

Sanders, W. G., & Carpenter, M. A. (1998). Internationalization and firm governance: The roles of CEO compensation, top team composition, and board structure. *Academy of Management Journal, 41*(2), 158–178.

Sinha, J. (2005). Global champions from emerging markets. *McKinsey Quarterly, 2*, 26–36.

Stoner, J. A. (1968). Risky and cautious shifts in group decisions: The influence of widely held values. *Journal of Experimental Social Psychology, 4*(4), 442–459.

Sundaram, A. K., & Black, J. S. (1992). The environment and internal organization of multinational enterprises. *Academy of Management Review, 17*(4), 729–757.

Sundaramurthy, C., & Lewis, M. (2003). Control and collaboration: Paradoxes of governance. *Academy of Management Review, 28*(3), 397–415.

Ward, A. J., & Feldman, D. C. (2008). Survival of the embedded: Expelling and embedding forces on members of the corporate elite. *Corporate Governance: An International Review, 16*(3), 239–251.

Wernerfelt, B. (1984). A resource-based view of the firm. *Strategic Management Journal, 5*(2), 171–180.

Westphal, J. D. (1999). Collaboration in the boardroom: Behavioral and performance consequences of CEO-board social ties. *Academy of Management Journal, 42*(1), 7–24.

World Investment Report. (2013). *Global value chains: Investment and trade for development*. UN. Available from http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf. Accessed 12 Oct 2015.

Wright, M., Filatotchev, I., Hoskisson, R. E., & Peng, M. W. (2005). Strategy research in emerging economies: Challenging the conventional wisdom. *Journal of Management Studies, 42*(1), 1–33.

Xie, Q. (2014). CEO tenure and ownership mode choice of Chinese firms: The moderating roles of managerial discretion. *International Business Review, 23*(5), 910–919.

Zahra, S. A., Neubaum, D. O., & Naldi, L. (2007). The effects of ownership and governance on SMEs' international knowledge-based resources. *Small Business Economics, 29*(3), 309–327.

Zahra, S. A., & Pearce, J. A. (1989). Boards of directors and corporate financial performance: A review and integrative model. *Journal of Management, 15*(2), 291–334.

Zahra, S. A., & Pearce, J. A. (1990). Determinants of board directors' strategic involvement. *European Management Journal*, *8*(2), 164–173.

4

Research in Multipoint Competition: What Do We Know and Where Are We Headed?

Rupanwita Dash

Introduction

Competition is a central element of strategy (Chen, 2009; Chen & Miller, 2012). Firms exist in competitive environment in which their strategic choices are influenced by the actions and responses of other firms. Action and reaction among firms in an industry create competitive dynamics (Smith, Ferrier, & Ndofor, 2001). While research on competition often implicitly assumes that it occurs within a single setting (Ketchen, Snow, & Hoover, 2004), in reality, large firms compete with each other across different markets. As firms expand their businesses into different markets, they form multiple contact points for competition, creating competitive interrelationships among rivals. "Multipoint competition" refers to the situation in which firms compete with each other in multiple situations, with respect to products, geographic regions, or market segments (Karnani & Wernerfelt, 1985). As firms are increasingly diversified, in both geographic

R. Dash (✉)
Indian Institute of Management Bangalore, Bangalore, India
e-mail: rupanwita.dash10@iimb.ernet.in

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_4

and product scope, multipoint (or multimarket) competition has emerged as an important context and research stream.

As noted by Upson, Ketchen, Conelly, and Ranft (2012), research on multipoint competition is often considered as a subset of the competitive dynamics literature. The survey papers by Smith, Ferrier, and Ndofor (2001), Ketchen et al. (2004), and Chen and Miller (2012) are focused on competitive dynamics; review and discussion on multipoint competition comprise subsections of these papers. Jayachandran, Gimeno, and Varadarajan (1999) provide a review focusing exclusively on multimarket completion, from a marketing strategy perspective. This chapter builds on the literature by mapping the breadth of current research on multipoint competition, with emphases on (1) distinguishing research on multipoint competition from that of competitive dynamics, and (2) illuminating how multipoint competition affects corporate-level strategy in the context of emerging-economy business groups, which offer a particularly interesting research context.

Multimarket research is a relatively new, yet steadily developing, stream with momentum gathered in the 1990s, as several studies established the evidence of multimarket competition across different industries such as the global tire industry (Gimeno, 1994; Ito & Rose, 2002; Rose & Ito, 2009); sets of related industries such as telephone and cable (Parker & Röller, 1997); and, most prominently, in the industries characterized by geographically distinct markets such as airlines, banks, hotels, and supermarket chains (Gimeno, 1994, 1999; Gimeno & Woo, 1996, 1999; Baum & Korn, 1999; Haveman & Nonnemaker, 2000; Yu, Subramaniam, & Cannella, 2009; Upson et al. 2012).

When two firms compete in a single-market setting with a single product, both compete for market share and profitability in one "space". Rivalry, in such cases, entails price wars and/or product differentiation. If these firms compete with each other across different geographic or product markets, the scope of the rivalry increases with more, and more complicated, contact between the firms. Competitive actions in one market can be answered by retaliatory moves in other markets. This offers firms flexibility, and more options, to strategize for their rivalry. For example, firms can respond to rival's actions in one market in the same or in different markets—markets in which the cost of retaliation is lower, the firm's competitive capabilities are stronger, or the markets are of less strategic importance. Firms with more market commonality may compete less aggressively with each other, "mutually forebear" (Edwards, 1955), and even tacitly collude with each other. Past research has shown that mutual forbearance can lead to higher profits (Barnett, Greve & Park, 1994; Piloff, 1999), higher prices (Feinberg, 1985; Evans & Kessides, 1994; Singal, 1996; Jans & Rosenbaum, 1997; Gimeno & Woo, 1996; Parker & Röller, 1997; Fernandez & Marin, 1998; Gimeno, 1999), and limited entry and exit among incumbent firms in interdependent markets (Barnett, 1993; Baum & Korn, 1996; Boeker, Goodstein, Stephan, & Murmann, 1997; Baum & Korn, 1999; Haveman & Nonnemaker, 2000; Fuentelsaz & Gómez, 2006; Anand, Mesquita, & Vassolo, 2009). Theoretically, multimarket contact offers the potential for more limited rivalry, in terms of intensity, and collusive behavior. Thus, this concept is important for both policymakers and managers, for better understanding of firm behavior.

The rest of the chapter is organized into four sections. First, I discuss how multipoint competition originated and developed as a research stream within the field of strategic management. Second, I discuss the characteristics of multipoint competition with respect to firms, industries, and markets. Third, I review the processes and outcomes of competition in multimarket situations, including market entry and exit, mutual forbearance, and multinational enterprise (MNE) rivalry. I conclude by proposing future research directions, focusing on three areas: the extent and implication of multipoint competition for business groups, linkages between multipoint competition and corporate governance, and the role played by the institutional environment in shaping rivalry within multipoint competition.

Review Method

Research on multipoint competition shares close, and often blurred, boundaries with competitive dynamics, interfirm rivalry, and oligopolistic collusion. Thus, it is important to delineate these boundaries and classify papers accordingly. The review includes published articles and book chapters that focus explicitly on multimarket competition, and some relevant articles from the competitive dynamics literature. Multipoint and multimarket are often used interchangeably in the literature, and I do not make any distinction between the two terms. The article search was conducted in three steps: first, by identifying survey papers and the articles mentioned therein; second, by searching articles from electronic databases such as Ebsco and ProQuest, with appropriate keywords; and third, from the citation lists generated by Harzing's Publish or Perish software. A cumulative list of all three of the search strategies produced close to 200 articles. This initial search was further refined to include only articles deemed relevant, after reading the abstracts. Following this, a few more articles were added through reference checking. The articles were then categorized by chronology, theories, emerging themes, and key questions addressed.

Multipoint Competition: Historical Roots and Subsequent Progress

Research on multipoint competition crosses the boundaries of industrial organization (IO) economics, marketing strategy research, and international business. In this section, I briefly discuss about these shared boundaries, and how the topic of multipoint competition has emerged as a distinct research area and gained prominence.

The origin of multipoint competition is rooted in IO economics and oligopoly theory. As firms compete simultaneously in multiple markets, both their intensity of rivalry and motivation to cooperate are influenced by the market interrelatedness. To that extent, multipoint competition is an extension of oligopoly theory. IO economists (e.g., Bernheim & Whinston, 1990; Edwards, 1955; Porter, 1980) argue that rivalry within an industry shapes competition, and that firms facing each other in a web of markets are likely to follow deterrence strategies as the advantage of a move in one market can be offset by retaliation in another market (Baum & Korn, 1999). Therefore, these firms are often less aggressive, even tacitly collusive. As Edwards (1955) notes,

> Firms that compete against each other in many markets, may hesitate to fight vigorously because the prospects of local gain are not worth the risk of general warfare. … A prospect of advantage from vigorous competition in one market may be weighed against the danger of retaliatory forays by the competitor in other markets. (from Corwin Edwards' testimony, cited in Scherer, 1980: 340)

At this stage, the unit of analysis was still the industry-level variable, such as one of Porter's five forces, that is, intensity of rivalry, and collusion. The seminal work by Karnani and Wernerfelt (1985) was one of the first to bring firm-level action into focus. They clarified the concept of multipoint competition as relevant to the strategy literature. The Karnani and Wernerfelt model explained entry behavior, response behavior, and competitive equilibriums (Smith & Wilson, 1995). Citing examples of multipoint competition from the US airline industry, the global tire industry, and the competition between BIC and Gillette, the authors elucidate four courses of actions that firms can take: (1) do nothing, (2) defend, (3) counterattack, and (4) total war (Karnani & Wernerfelt, 1985: 92). Doing nothing may signal weakness on the part of the firm, and may further erode competitive position; hence, it is not really a viable option in many cases. Defending involves a response in the same market, by price cut or differentiation, whereas counterattack involves moves in another market as a response to a rival's action in the focal market. Defending leads to a limited war equilibrium, where both firms settle into a mutually acceptable price level; counterattack leads to a mutual foothold equilibrium, in which both firms accept each other's presence in both markets with certain tradeoffs. These last two are equilibrium conditions that last until some change occurs in the market, the environment, or firm characteristics.

The next seminal theoretical advance was made by Chen (1996), who added a strategic dimension of "resource similarity" to the already established marketing dimension of "market commonality", and argued that it is the integration of these two that decides the competitive dynamics. According to Chen, firms may compete simultaneously in multiple markets, but may not pose equal threats to each other. While Karnani and Wernerfelt (1985) elaborated on the action–reaction aspects of rivalry, Chen (1996) added one step in between, that is, the drivers of competitive behavior in the form of awareness, motivation, and capability (the AMC framework). Firms may want to engage in, or refrain from, certain types and extents of rivalry in multimarket contacts; however, what they can actually do is influenced by their awareness, motivation, and capability. Since managers have bounded rationality and unique thought processes, the competitive asymmetry between two firms is much more complex than mere market presence. Subsequently, Baum and Korn (1999) posited a further micro-level analysis—the dyadic interaction of action-response as the unit of analysis. They also argued that multimarket contact leads to mutual forbearance in terms of market entry and exit, but that the relationship is nonlinear, following an inverted U-shape pattern.

Research in multipoint competition has developed along these key themes: antecedents of multimarket contact (Korn & Baum, 1999), mutual forbearance (Edwards, 1955; Baum & Korn, 1996; Gimeno & Woo, 1996, 1999), foothold moves (Upson et al., 2012), implications for market entry (Baum & Korn, 1999; Haveman & Nonnemaker, 2000; Fuentelsaz & Gómez, 2006), implications for market exit (Boeker et al., 1997), resource similarity (Chen, 1996; Young, Smith, Grimm, & Simon, 2000), resource diversion (McGrath, Chen, & MacMillan, 1998), CEO tenure (Stephan, Murmann, Boeker, & Goodstein, 2003), links with economics of scope (Baum & Korn, 1996; Gimeno & Woo, 1999), and links with performance (Scott, 1982; Gimeno, 1994; Gimeno & Woo, 1999; Guedri & McGuire, 2011). Important development in this field came from empirical studies across an array of industries and markets, as presented in Table 4.1.

Major conceptual advances have come in the form of formal modeling of collusion in multimarket settings (Bernheim & Whinston, 1990), entry strategies and entry deterrence (Van Wegberg & Van Witteloostuijn, 1991), the awareness–motivation–capability framework (Chen, 1996), and restructuring of competition and spheres of influence by resource allocation and diversion (McGrath et al., 1998). Firms competing under multimarket contact have the broader option of choosing to retaliate across one or more markets, depending on cost or feasibility and maximum potential to hurt the rival. The potential

Table 4.1 Research on multipoint competition in various industries

Industry/context	Study
Airlines	Evans and Kessides (1994), Baum and Korn (1996, 1999), Gimeno and Woo (1996, 1999), Gimeno (1999)
Automobiles	Yu, Canella, and Subramanian (2009), Yu and Canella (2007)
Banks	Heggestad and Rhoades (1978), Roadhes and Heggestad (1985), Mester (1987), Pillof (1999), Barros (1999), Haveman and Nonnemaker (2000)
	Berger, Dick, Goldberg, and White (2007), Fuentelsaz and Gomez (2006)
Cement	Jans and Rosembaum (1997)
Hotels	Fernández and Marín (1998)
Hospitals	Boeker et al. (1997), Baum et al. (2000), Stephan et al. (2003)
Insurance	Greve (2008), Li and Greenwood (2004)
Manufacturing	Scott (1982, 1991), Feinberg (1985), Hughes and Oughton (1993)
Newspaper	Fu (2003)
Software firms	Young et al. (2000), Kang, Bayus, and Balasubramanian (2010)
Telephone and cellular	Barnett (1993), Parker and Röller (1997), Busse (2000)
Tires	Gimeno (1994), Ito and Rose (2002), Rose and Ito (2009)

profit resulting from obtaining an advantage in one market is weighed against the threat and cost of retaliation in one or more different markets in which firms come in contact with each other. Thus, firms have incentive to be more careful in such situations, with respect to engaging in intense rivalry, which may lead them to compete less aggressively. This mutual recognition of threat may lead firms to mutually forbear, or even to cooperate.

In formal terms, mutual forbearance is "the ceding of control of one product or geographic market to a competitor in exchange for that competitor's acquiescence in another market" (Golden & Ma, 2003: 479). According to the mutual forbearance perspective, multimarket contact should result in higher prices and higher profits. The empirical evidence supports the outcomes of increased prices (Gimeno, 1999; Gimeno & Woo, 1996; Parker & Röller, 1997), profits (Phillips & Mason, 1992), and growth (Haveman & Nonnemaker, 2000). Table 4.2 lists some of the key empirical papers and their findings.

Table 4.2 Some key empirical studies

Study	Findings
Scott (1982)	Multimarket contact alone leads to lower profits, but when both contact and seller concentrations are high, profit is also higher
Baum and Korn (1996)	Market domain overlap raised airlines' rates of market entry and exit, while multimarket contact lowered them, especially in markets dominated by a single airline
Gimeno and Woo (1996)	Multimarket contact reduces rivalry, but strategic similarity between firms moderately increases its intensity
McGrath, Chen, and MacMillan (1998)	Firms can try to shift a mutual forbearance-based equilibrium by changing their position in one or more markets, and can engage a competitor in one market by shifting its resources from other market as a diversion tactic
Baum and Korn (1999)	An inverted U-shaped relationship is found between firms' rates of entry into and exit from each other's markets and the level of multimarket contact in competitor dyads. This curvilinear effect varies from dyad to dyad, as a function of relative levels of multimarket contact with competitors in other dyads and relative sizes of competitors in a focal dyad
Gimeno and Woo (1999)	Firms with higher economies of scope increase their multipoint contacts with similar firms. The resulting multimarket competition (MMC) and the firms' abilities to share resources influence efficiency, rivalry, and profitability
Stephan et al. (2003)	Focusing on the role of managers, short-tenure CEOs may opt for higher multimarket entry; for others, tenure and the degree of MMC follow an inverted U-shape
Fuentelsaz and Gomez (2006)	Both multimarket contact and strategic similarity are important antecedents in the analysis of entry decisions
Yu and Canella (2007)	When multinational enterprises (MNEs) are engaged in rivalry in host country market, their speed of response to an attack is influenced by resources, government constraints, subsidiary control, multimarket contact, and the strategic significance of the market

(*continued*)

Table 4.2 (continued)

Study	Findings
Yu, Subramaniam, and Cannella (2009)	Though multimarket provides broader competitive options, for MNEs, these options are modified by subsidiary ownership, home-host cultural distance, host country regulatory restrictions on MNC activities, and the presence of local competitors
Kang, Bayus, and Balasubramanian (2010)	Under multimarket contact, firms mutually forbear in terms of price and new product introductions. In case of competitive attacks, firms can respond by introducing new products, and may or may not alter pricing decisions
Guedri and McGuire (2011)	For strategic groups with high mobility barriers, multimarket competition has strong positive effect on firm performance. As the barrier lessens, this effect reduces, becoming negative for groups surrounded by low mobility barriers

Jayachandran et al. (1999) were the first to synthesize the work on multimarket contact and its implication for intensity of competition as relevant to the marketing literature. Yu and Canella (2013) provide the most recent review article on multimarket research. Also, scholarly work summarizing the literature in the field of competitive dynamics touches upon multipoint competition (see Table 4.3 for details). As research on competitive dynamics gained prominence in the 1990s, its first consolidation within the field of strategic management was undertaken by Smith, Ferrier, and Ndofor (2001). Their review was focused on empirical studies and had a sample of 30 published articles. They elucidated the competitive relationships through a model consisting of the actor (firm that takes a competitive action), the competitive action (type or magnitude of the action), the responder (firm that reacts), the response to the action, the industry context of the competitive activity, and the associated performance outcomes. This was the first stock-taking attempt in mapping the field of competitive dynamics and critiquing the theories, samples, and methods. The study touched on multipoint competition as an organizational characteristic that influences competitive actions.

Table 4.3 Stock-taking papers in multipoint research

Paper	Focus	Contributions	Suggested future directions
Chen and Miller (2012)	Organizing the competitive dynamics literature into a synthesizing framework linking strategy content and process, capabilities, and market perspectives, and macro-competitive and micro-actor viewpoints	Comprehensive review of competitive dynamics research in the AMC framework Critique of data, samples, and methods used Research gaps and future potential within each theme Arguments for using new theories such as institutional, evolutionary, population ecology, and network	How does a firm orchestrate various business units or external forces to engage in corporate-level competition? Impact of organizational and strategic characteristics of a corporate headquarters on the competitive behavior of its business units Inter-unit competition Competitive dynamics with a given rival across various regional markets or across countries New product launch in MNEs Rivalry at the city, national, and regional levels
Ketchen, Snow, and Hoover (2004)	Organizing the competitive dynamics literature in six streams: action and response, first-mover advantage, coopetition, multipoint competition, strategic groups, and regional clusters	Multipoint competition as a contingency variable in market entry and exit by firms Preliminary research on how firms assess MPC, and when and why they mutually forbear	Managerial interpretations of how and why multipoint competition emerges and evolves Multiple firms in competitive contact and links to firm performance Models with three or more firms in both direct and indirect competition
Jayachandran, Gimeno, and Varadarajan (1999)	The process of mutual forbearance, the moderating effects of market variables and implications of multimarket contact for marketing strategy	Two processes—familiarity and deterrence lead to mutual forbearance as a result of multimarket contact	Relation between deterrence and familiarity Cognition aspects, mental map of managers Deliberate use of MMC for cooperation MNE rivalry

What Is Multipoint Competition and How Is It Distinct from Competitive Dynamics?

Since research on competitive interaction as well as multipoint competition among firms was rooted in the IO view and game theoretic models, the focus until Karnani and Wernerfelt (1985) was, by and large, on temporal action sequences and firms' collusive behavior. Karnani and Wernerfelt (1985) emphasized firm-to-firm interactions in multipoint competition situations, thus shifting the focus from the industry to the firm. Gimeno (1994) empirically tested the effects of multimarket contact at the firm level, and Chen (1996) added momentum to this by clarifying the IO economists' idea of competitive dynamics from a temporal consideration to an interactive process between the firms. Around the same time, Baum and Korn (1996: 255) distinguished between the notion of competition and rivalry:

> In economic theory, for example, competition is a property of market structure whose form is determined by market forces not subject to the conscious control of individual firms. Similarly, in organizational ecology, competition occurs as largely anonymous organizations vie for a limited common pool of resources. These definitions of competition differ markedly from the conceptions of rivalry.

Interfirm rivalry is the extent to which firms compete against each other in a specific market through actions and reactions; it influences their ability to gain and sustain competitive advantage (Dickson, 1992; Porter, 1980). The essence of rivalry, as argued by Caves (1984), Scherer and Ross(1990), and Hannan and Freeman (1989), is a striving by firms for potentially incompatible positions through an interplay of action-response with respect to each other's competitive moves. Instead of treating competition as a property of markets, industries, or populations, Baum and Korn (1996) argue for a more relational view of competition, where firms try to attain competitive advantage by taking actions that affect other firms, understanding that firms' market positions affect their strategic interactions. Thus, the concept of interfirm rivalry emerged with clarity, with firms and their interactions as the focus.

Multiple point competition is closely related to, yet distinguished from, interfirm rivalry (Chen & Miller, 2012). While rivalry is related to relative market positions, multipoint competition is a special case of rivalry, in which firms compete with each other across more than one market. Karnani and Wernerfelt (1985: 87) define multipoint competition as "a situation where firms compete against each other simultaneously in several markets". In their definition, multiple markets refer to geographical markets, product markets, and even different segments of the same product market. Thus, multipoint competition is a result of increased product diversification, geographic market diversification, and greater use of coordinated worldwide strategies by MNEs (Gimeno & Woo, 1999).

Prior to Chen (1996), the intensity of rivalry was studied as an industry-level variable (Porter, 1980). Chen (1996) linked rivalry intensity to the market context in which competition takes place among the firms. This linkage is important, as the intensity of rivalry is altered when firms are engaged in multimarket competition, due to greater interdependencies among the firms and increased the opportunities to compete and retaliate across multiple markets (Jayachandran et al., 1999).

Both Firm and Industry Considerations Are Important

Though rivalry is a common aspect of virtually any industry, the dynamics change when multiple markets are considered together. Porter's (1980) concept of "rivalry"' as one of the forces shaping competition is entrenched at the industry level, and is concerned with the incumbent firms in a single industry setting. Complementing this, van Witteloostuijn and van Wegberg (1992) presented five key features that drive rivalry in multimarket contact: (1) the focus of rivalry can be either entry or price; (2) resource-economizing entry is important, since it diverts resources from the home market and, if the opportunity cost of new entry is high, a firm may choose to retaliate only in same market; (3) multimarket spillovers (externalities between two or more markets) in the form of economies of scale and scope, leveraging resources, and reputation; (4) one-sided entries can result due to high entry costs or legal protection; reciprocal entries are made to keep competition in check by forcing the attacker to divert resources and by maintaining a foothold; and (5) multimarket collusion as a result of firms' recognition of interdependence that leads to reduction of rivalry.

It is clear that both industry- and firm-level variables influence the degree and nature of multipoint competition. As Baum and Korn (1999: 252) argue,

> Multimarket contact is not an aggregate property of industries, markets, or firms; it is a property of the relationship between two firms. This relationship is defined by the intersection of their (multi)market activities, which is established through a dynamic interaction across markets and over time and reflects their efforts to coordinate activities across all markets in which they meet. Such coordination across markets and time is taken for granted in theoretical accounts of multipoint competition and is the main theoretical basis for expecting mutual forbearance.

Multipoint competition is highly industry-specific. For example, some industries have particularly high entry barriers, making retaliation by entry difficult or even impossible. Similarly, industries that are characterized by high consumer loyalty make the entry of a counter-attacker very costly. Industries differ in terms of first-mover advantage and economies of scale, which also influence the rationality of entry or protecting one's turf.

At the same time, firm-specific characteristics also determine the extent of multipoint contact. If a certain market is the source of major sales volume, or is of strategic importance to a firm, especially a core business or one with high economies of scope, the firm's effort to protect it is likely to be higher. Some managers are quicker to perceive rivals' competing moves, and thus react faster and more effectively. This is a very firm-specific characteristic. Firms also differ in their capacity to respond, in terms of experiences, resource slack, and risk propensity.

Multipoint Competition as a Corporate-Level Strategy

Entry into new markets and businesses (Haveman, 1993), as well as exit from markets, shape the competitive landscape and are important corporate-level decisions (Boeker et al., 1997). Firms' entry and exit decisions determine their market portfolio and overall scope of competition. Multipoint contact creates avenues for competition across products, geographic regions, or market segments (Karnani and Wernerfelt, 1985); since multiple markets compete for a firm's limited resources, the decisions on which markets to compete in become important questions. On a similar note, Chen and Miller (2012) posit that multimarket competition provides a theoretical framework in which to investigate interfirm rivalry at the corporate level.

Future Research Directions

The literature on multimarket competition has developed along the lines of competitive structure and behavior (Boeker et al., 1997; Fuentelsaz & Gómez, 2006), and the impact of multimarket contact on different market conditions (Gimeno, 1999). To date, there has been a strong emphasis on the anti-competitive consequences of multimarket contacts through changes in prices, profits, or market share. Given the advantages of multimarket contact, it can be argued that firms would do well to actively seek ways to develop and increase contact with their rivals. Therefore, the drivers of multimarket contact, and why some firms are more intent on creating multimarket contact than others, represent important questions for interfirm rivalry research. While the outcome of multimarket competition is well-studied, the antecedents of multimarket contact are still underexplored, with a few exceptions such as Korn and Baum (1999) and Greve (2000, 2006). Investigating the firm-level strategic and organizational aspects that shape this potentially anti-competitive behavior can add interesting insights to the field of multimarket competition. Future research can focus on two additional such firm-specific aspects: (1) multimarket competition in multi-business firms or business groups, and (2) corporate governance aspects such as the roles of board composition and top management team dynamics in shaping multimarket competition. The other conspicuous gap in the current literature is a relative lack of studies pertaining to the emerging-economy context. Some of the exceptions are Hu and Kuang (2008), Zhang and Round (2009), and Zhang (2011), pertaining to the Chinese airline industry. This is an especially important research context, given that firms are becoming increasingly globalized and investigating emerging-economy settings, with their distinct institutional environments, can offer important insights into the robustness of the existing knowledge on multimarket competition. Developing a framework for investigation, shown in Fig. 4.1, I discuss these potential research issues in detail.

As noted by Chen and Miller (2012), the study of corporate-level strategy and competition is becoming important, along with the growing importance of diversified national, multimarket, and multinational firms. In the Indian context, business groups are the most prominent form of such multi-unit and multimarket firms that compete with each other simultaneously in a variety of markets. Firms affiliated to business groups tend to exhibit high degrees of strategic and capability relatedness, which may result in market relatedness with other firms of the group. Business groups, like multi-divisional firms, have internal capital markets; when they engage in multipoint competition, resource diversion strategies can lead to serious internal competition for resources. Issues of how resources are allocated among units, where slack is used, and how internal dynamics shape up all create interesting avenues for future research. Currently, Kalnins (2004) is the only study on intra-organizational rivalry that tests multimarket competition between franchises. Similar studies on group-affiliated firms can show how rivalry pans out between divisions, and under what conditions promoting divisional rivalry can benefit the headquarters or the firm as a whole.

Past research has shown that multimarket contact has implications for entry and exit (Anand et al., 2009; Baum & Korn, 1996; Boeker et al., 1997; Haveman & Nonnemaker, 2000); these are strategic decisions, as they involve significant commitment of resources. The top management team, the owners, and the board of directors play important roles in taking and implementing such decisions (Amihud & Lev, 1999). Recent papers in the area of competitive dynamics have tried to integrate corporate governance aspects with competitive actions (He & Mahoney, 2006; Connelly, Tihanyi, Certo, & Hitt, 2010). Extending these studies by adding the multimarket context can lead to the consideration of new questions related to the role of the board, top management teams, and institutional investors in shaping competitive actions. The literature contains evidence that the top management team size, composition, experience, education, and

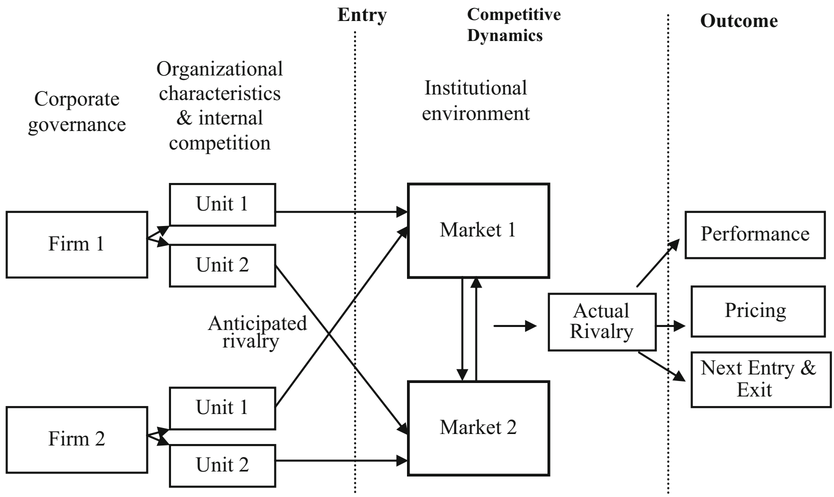


Fig. 4.1 Conceptual framework for future research

tenure influence the array of competitive actions taken, response type, and speed (Hambrick & Mason, 1984; Smith et al., 1991; Hambrick, Cho, & Chen, 1996; Ferrier, 2000; Stephan et al., 2003).

Another stream of work that can illuminate the macro context in which multipoint competition takes place is additional study of institutional environments, and their impact on the shaping of both competitive behavior and strategic choices in emerging economies. Institutional theory suggests that striving for legitimacy drives the choices of actions, and that firms compete within given institutional norms. Over time, out of an array of possible competitive actions, the ones that are legitimate in that institutional context, and meet the socialization and pressure to conform, become prominent and practiced. Some of the market entry, exit, and pricing decisions can be results of firms' seeking legitimacy, thus moderating the effect of multimarket competition. On a parallel line, Northian institutional theory argues that firms' actions are constrained and shaped by the policies, incentive structures, and enforcement mechanisms in the institutional environment. Different markets are characterized by different institutional environments, thus creating limits to the set of retaliating options otherwise created by multimarket contact.

For example, countries such as India have policies regarding price regulation of many drugs. When certain molecules or drugs are price-regulated and others are not, such policies can influence firms' competitive moves and countermoves. This offers another promising area for future research.

Conclusion

Multimarket contact increases the firms' familiarity with its competitors, and improves managers' abilities to guess rivals' intentions, capabilities, and moves. Thus, it enables firms to form strategies with a better understanding of competition. At the same time, it can also limit rivalry, due to the potential of retaliation from competitors. In this light, multipoint contacts can be seen to alter the competitive dynamics and firm-level strategies and actions, relative to what they might have been in a single-market context.

Multipoint competition has developed into a distinct branch of competitive dynamics research, through the cross-fertilization of ideas from IO economics, strategic management, and marketing strategy. With momentum gained in the 1990s, scholarly publication in this branch continues to flourish. However, an emphasis on micro-behavioral aspects, with an outcome focus, has continued to dominate the field. Future research will benefit from integrating some of the macro-contexts, such as institutional environment, organizational dynamics of business groups, and corporate governance considerations, into this important line of research.

References

Amihud, Y., & Lev, B. (1999). Does corporate ownership structure affect its strategy towards diversification? *Strategic Management Journal*, *20*(11), 1063–1069.

Anand, J., Mesquita, L. F., & Vassolo, R. S. (2009). The dynamics of multimarket competition in exploration and exploitation activities. *The Academy of Management Journal, 52*(4), 802–821.

Barnett, W. P. (1993). Strategic deterrence among multipoint competitors. *Industrial and Corporate Change, 2*(2), 249–278.

Barnett, W. P., Greve, H. R., & Park, D. Y. (1994). An evolutionary model of organizational performance. *Strategic Management Journal*, *15*(S1), 11–28.

Barros, P. P. (1999). Multimarket competition in banking, with an example from the Portuguese market. *International Journal of Industrial Organization*, *17(*3), 335–352.

Baum, J. A. C., & Korn, H. J. (1996). Competitive dynamics of interfirm rivalry. *Academy of Management Journal, 39*(2), 255–291.

Baum, J. A. C., & Korn, H. J. (1999). Dynamics of dyadic competitive interaction. *Strategic Management Journal, 20*(3), 251–278.

Baum, J. A., Li, S. X., & Usher, J. M. (2000). Making the next move: How experiential and vicarious learning shape the locations of chains' acquisitions. *Administrative Science Quarterly*, *45*(4), 766–801.

Berger, A. N., Dick, A. A., Goldberg, L. G., & White, L. J. (2007). Competition from large, multimarket firms and the performance of small, single-market firms: Evidence from the banking industry. *Journal of Money, Credit and Banking, 39*(2–3), 331–368.

Bernheim, B. D., & Whinston, M. D. (1990). Multimarket contact and collusive behavior. *The RAND Journal of Economics, 21*(1), 1–26.

Boeker, W., Goodstein, J., Stephan, J., & Murmann, J. P. (1997). Competition in a multimarket environment: The case of market exit. *Organization Science, 8*(2), 126–142.

Busse, M. R. (2000). Multimarket contact and price coordination in the cellular telephone industry. *Journal of Economics & Management Strategy*, *9*(3), 287–320.

Caves, R. E. (1984). Economic analysis and the quest for competitive advantage. T*he American Economic Review*, *74*(2), 127–132.

Chen, M. J. (1996). Competitor analysis and interfirm rivalry: Toward a theoretical integration. *Academy of Management Review, 21*(1), 100–134.

Chen, M. J. (2009). Competitive dynamics research: An insider's odyssey. *Asia Pacific Journal of Management, 26*(1), 5–25.

Chen, M. J., & Miller, D. (2012). Competitive dynamics: Themes, trends, and a prospective research platform. *The Academy of Management Annals, 6*(1), 135–210.

Connelly, B. L., Tihanyi, L., Certo, S. T., & Hitt, M. A. (2010). Marching to the beat of different drummers: The influence of institutional owners on competitive actions. *Academy of Management Journal, 53*(4), 723–742.

Dickson, P. R. (1992). Toward a general theory of competitive rationality. *The Journal of Marketing*, 69–83.
Edwards, C. D. (1955). Conglomerate bigness as a source of power. In *NBER report: Business concentration and price policy* (pp. 331–352). Princeton, NJ: Princeton University Press.
Evans, W. N., & Kessides, I. N. (1994). Living by the "golden rule": Multimarket contact in the US airline industry. *The Quarterly Journal of Economics*, 341-366.
Feinberg, R. M. (1985). "Sales-at-risk": A test of the mutual forbearance theory of conglomerate behavior. *Journal of Business, 58*(2), 225–241.
Fernandez, N., & Marin, P. L. (1998). Market power and multimarket contact: Some evidence from the Spanish hotel industry. *The Journal of Industrial Economics, 46*(3), 301–315.
Ferrier, W. (2000). Playing to win: the role of competitive disruption and aggressiveness. In R. K. Bresser, M. A. Hitt and D. Heuskel (Eds.), *Winning strategies in a deconstructing world*, John Wiley and Sons Ltd, 163–189.
Fu, W. W. (2003). Multimarket contact of US newspaper chains: Circulation competition and market coordination. *Information Economics and Policy, 15*(4), 501–519.
Fuentelsaz, L., & Gómez, J. (2006). Multipoint competition, strategic similarity and entry into geographic markets. *Strategic Management Journal, 27*(5), 477–499.
Gimeno, J. (1994). *Multipoint competition, market rivalry and firm performance: A test of the mutual forbearance hypothesis in the U.S. airline industry, 1984–1988*. Unpublished Doctoral Dissertation, Purdue University, West Lafayette, IN.
Gimeno, J. (1999). Reciprocal threats in multimarket rivalry: Staking out spheres of influence in the US airline industry. *Strategic Management Journal, 20*(2), 101–128.
Gimeno, J., & Woo, C. Y. (1996). Hypercompetition in a multimarket environment: The role of strategic similarity and multimarket contact in competitive de-escalation. *Organization Science, 7*(3), 322–341.
Gimeno, J., & Woo, C. Y. (1999). Multimarket contact, economies of scope, and firm performance. *Academy of Management Journal, 42*(3), 239–259.
Golden, B. R., & Ma, H. (2003). Mutual forbearance: The role of intrafirm integration and rewards. *The Academy of Management Review, 28*(3), 479–493.
Greve, H. R. (2000). Marketing niche entry decisions: Competition, learning, and strategy in Tokyo banking, 1894-1936. *Academy of Management Journal*, *43(*5), 816–836.

Greve, H. R. (2006). The intent and extent of multimarket contact. *Strategic Organization, 4*(3), 249–274.

Greve, H. R. (2008). Multimarket contact and sales growth: Evidence from insurance. *Strategic Management Journal, 29*(3), 229–249.

Guedri, Z., & McGuire, J. (2011). Multimarket competition, mobility barriers, and firm performance. *Journal of Management Studies, 48*(4), 857–890.

Hambrick, D. C., Cho, T., & Chen, M. J. (1996). The influence of top management team heterogeneity on firms' competitive moves. *Administrative Science Quarterly, 41*, 659–684.

Hambrick, D. C., & Mason, P. (1984). Upper echelons: The organization as a reflection of its top managers. *Academy of Management Review, 9*, 193–206.

Hannan, M. T., & Freeman, J. (1989). *Organization ecology*. Cambridge, MA: Harvard University Press.

Haveman, H. A. (1993). Follow the leader: Mimetic isomorphism and entry into new markets. *Administrative Science Quarterly*, 593–627.

Haveman, H. A., & Nonnemaker, L. (2000). Competition in multiple geographic markets: The impact on growth and market entry. *Administrative Science Quarterly, 45*(2), 232–267.

He, J., & Mahoney, J. T. (2006). *Firm capability, corporate governance, and firm competitive behavior: A multi-theoretic framework*. Working Paper, College of Business, University of Illinois at Urbana-Champaign.

Heggestad, A. A., & Rhoades, S. A. (1978). Multi-market interdependence and local market competition in banking. *The Review of Economics and Statistics*, 523–532.

Hu, R., & Kuang, L. (2008). Multi-market contact and market competitive conduct: A case study on China's civil aviation transport. *Tourism Tribune, 6*, 68–73.

Hughes, K., & Oughton, C. (1993). Diversification, multi-market contact and profitability. *Economica, 60*(238), 203–224.

Ito, K., & Rose, E. L. (2002). Foreign direct investment location strategies in the tire industry. *Journal of International Business Studies, 33*(1), 593–602.

Jans, I., & Rosenbaum, D. I. (1997). Multimarket contact and pricing: Evidence from the US cement industry. *International Journal of Industrial Organization*, *15*(3), 391–412.

Jayachandran, S., Gimeno, J., & Varadarajan, P. R. (1999). The theory of multimarket competition: A synthesis and implications for marketing strategy. *The Journal of Marketing, 63*, 49–66.

Kalnins, A. (2004). Divisional multimarket contact within and between multiunit organizations. *Academy of Management Journal, 47*(1), 117–128.

Kang, W., Bayus, B. L., & Balasubramanian, S. (2010). The strategic effects of multimarket contact: Mutual forbearance and competitive response in the personal computer industry. *Journal of Marketing Research, 47*(3), 415–427.

Karnani, A., & Wernerfelt, B. (1985). Multiple point competition. *Strategic Management Journal*, *6*(1), 87–96.

Ketchen, D. J., Snow, C. C., & Hoover, V. L. (2004). Research on competitive dynamics: Recent accomplishments and future challenges. *Journal of Management, 30*(6), 779–804.

Korn, H. J., & Baum, J. A. C. (1999). Chance, imitative, and strategic antecedents to multimarket contact. *Academy of Management Journal, 42*(2), 171–193.

Li, S. X., & Greenwood, R. (2004). The effect of within-industry diversification on firm performance: synergy creation, multi-market contact and market structuration. *Strategic Management Journal*, *25*(12), 1131–1153.

McGrath, R. G., Chen, M. J., & MacMillan, I. C. (1998). Multimarket maneuvering in uncertain spheres of influence: Resource diversion strategies. *Academy of Management Review, 23*(4), 724–740.

Mester, L. J. (1987). Multiple market contact between savings and loans. *Journal of Money, Credit and Banking*, *19*(4), 538–549.

Parker, P. M., & Röller, L. H. (1997). Collusive conduct in duopolies: Multimarket contact and cross-ownership in the mobile telephone industry. *The RAND Journal of Economics, 28*(2), 304–322.

Phillips, O. R., & Mason, C. F. (1992). Mutual forbearance in experimental conglomerate markets. *The RAND Journal of Economics, 23*(3), 395–414.

Pilloff, S. J. (1999). Multimarket contact in banking. *Review of Industrial Organization*, *14*(2), 163–182.

Porter, M. E. (1980). *Competitive strategy*. New York: Free Press.

Rhoades, S. A., & Heggestad, A. A. (1985). Multimarket interdependence and performance in banking: Two tests. *Antitrust Bulletin*, *30*, 975–995.

Rose, E. L., & Ito, K. (2009). Past interactions and new foreign direct investment location decisions: Firm-specific analysis in the global tire industry. *Management International Review, 49*(5), 641–669.

Scherer, F. M. (1980). *Industrial market structure and economic performance*. Boston, MA: Houghton Miffin.

Scherer, F. M., & Ross, D. (1990). *Industrial market structure and economic performance*. Boston, MA: Houghton Mifflin.

Scott, J. T. (1982). Multimarket contact and economic performance. *The Review of Economics and Statistics, 64*(3), 368–375.

Scott, J. T. (1991). Multimarket contact among diversified oligopolists. *International Journal of Industrial Organization, 9*(2), 225–238.

Smith, F. I., & Wilson, R. L. (1995). The predictive validity of the Karnani and Wernerfelt model of multipoint competition. *Strategic Management Journal, 16*(2), 143–160.

Smith, K. G., Ferrier, W. J., & Ndofor, H. (2001). Competitive dynamics: A critique of theory and research. In M. A. Hitt, R. Freeman, & J. Harrison (Eds.), *Handbook of strategic management* (pp. 315–361). Oxford: Blackwell Publishers.

Singal, V. (1996). Airline mergers and multimarket contact. *Managerial and Decision Economics*, *17*(6), 559–574.

Smith, K. G., Grimm, C. M., Gannon, M. J., & Chen, M. J. (1991). Organizational information processing, competitive responses, and performance in the US domestic airline industry. *Academy of Management Journal*, *34*(1), 60–85.

Stephan, J., Murmann, J. P., Boeker, W., & Goodstein, J. (2003). Bringing managers into theories of multimarket competition: CEOs and the determinants of market entry. *Organization Science, 14*(4), 403–421.

Upson, J. W., Ketchen, D. J., Connelly, B. L., & Ranft, A. L. (2012). Competitor analysis and foothold moves. *Academy of Management Journal, 55*(1), 93–110.

Upson, J. W., & Ranft, A. L. (2010). When strategies collide: Divergent multipoint strategies within competitive triads. *Business Horizons, 53*(1), 49–57.

Van Wegberg, M., & Van Witteloostuijn, A. (1991). Multimarket competition: Entry strategies and entry deterrence when the entrant has a home market. In J. Thepot & R. A. Thietart (Eds.), *Microeconomic contributions to strategic management* (Advanced series in management, Vol. 16, pp. 93–119). Amsterdam: Elsevier Science.

Van Witteloostuijn, A., & Van Wegberg, M. (1992). Multimarket competition: Theory and evidence. *Journal of Economic Behavior & Organization, 18*(2), 273–282.

Young, G., Smith, K. G., Grimm, C. M., & Simon, D. (2000). Multimarket contact and resource dissimilarity: A competitive dynamics perspective. *Journal of Management, 26*(6), 1217–1236.

Yu, T., & Cannella, A. A. (2007). Rivalry between multinational enterprises: An event history approach. *Academy of Management Journal, 50*(3), 665–686.

Yu, T., & Cannella, A. A. (2013). A comprehensive review of multimarket competition research. *Journal of Management, 39*(1), 76–109.

Yu, T., Subramaniam, M., & Cannella, A. A. (2009). Rivalry deterrence in international markets: Contingencies governing the mutual forbearance hypothesis. *Academy of Management Journal, 52*(1), 127–147.

Zhang, Y. (2011). The Shanghai-Beijing "Air Express" service model and its impact on the pricing behaviour of airlines. *Asia Pacific Journal of Tourism Research, 16*(4), 433–443.

Zhang, Y., & Round, D. K. (2009). Policy implications of the effects of concentration and multimarket contact in China's airline market. *Review of Industrial Organization, 34*(4), 307–326.

Part II

Strategic Changes in Organizational Forms

5

Internalization of IJVs and Institutions

Shailen Kumar Dalbehera, S. Raghunath, R. Srinivasan, Murali Patibandla, and V. Nagadevara

Introduction

Joint ventures (JVs) can be temporary organizational forms (Franko, 1971; Peng & Shenkar, 2002; Serapio & Cascio, 1996). Upon termination, a JV can be sold off by its present parent firms to a third party; one of the parent firms can buy the remaining controlling shares from the other parent(s), or the firm may be liquidated. In case of insolvency, or when both the parents decide to exit the business because of changes in their corporate strategies, they are likely to choose sell-off or liquidation. When only one of the firms

S.K. Dalbehera (✉) • S. Raghunath • R. Srinivasan • M. Patibandla
Indian Institute of Management Bangalore, Bengaluru, India
e-mail: shailen.dalbehera09@iimb.ernet.in; srnathiimb@gmail.com; srini@iimb.ernet.in; muralip@iimb.ernet.in

V. Nagadevara
Woxsen School of Business, Hyderabad, India
e-mail: nagadev@iimb.ernet.in

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_5

considers the JV unfit for its current strategy, it may choose to terminate the venture (Raghunath, 1998). In such cases, the other partner(s) may choose to acquire the shares of the exiting partner or have a third-party firm buy those shares and become a new partner in the JV.

When all of the parent firms are interested in continuing to do business in the same sector as that of the JV, and not pursuing more market-oriented (vs. hierarchy-oriented) mode choices, such as licensing, the mode change choice should lead to a wholly owned subsidiary (WOS) (Makino, Chan, Isobe, & Beamish, 2007). In such cases, the JV is a good acquisition candidate for its parent firms, upon termination. With full knowledge of its operations, the scope of due diligence required is lower, and the JV may be more readily integrated into the partner firm, as the JV's culture is likely to have some imprint from that of its parent firms. The JV can add immediately to resources of the parent acquiring it, giving scale and/or scope advantages to the acquirer. At the same time, the other (former) partners lose these advantages. While they can make up for it by either acquiring another firm with similar operations or undertaking a greenfield investment, these actions will incur additional costs associated with search, due diligence, and integration, in case the other partner(s) choose(s) to acquire another firm from the market. A greenfield investment will require time to attain the scale of the JV. Such transaction costs, however, may not be covered by the price at which the selling partner(s) release(s) the JV stake(s) to the acquiring partner. Hence, if a partner wishes to continue operating in the JV's business segment, there is logic in their competing strongly with the other partner(s) to acquire the JV. Because of these advantages, the JV should be a more appealing acquisition target for the parent firms, rather than for others. Moreover, the parent firms have deeper knowledge about the JV, relative to other firms in the market. Hence, the costs should be higher for third-party firms, because of the increased costs associated with due diligence and integration. Thus, JVs, upon termination, are highly likely to be internalized by one of the parent firms (Steensma, Barden, Dhanaraj, Lyles, & Tihanyi, 2008).

"Internalization" is an often-used term in the international business literature (Dunning, 2003). As used in the context of internalization theory, it discusses the boundaries of the firm's decision making, building on transaction cost theory; intermediate products and services for which markets are imperfect can be internalized, such that they are owned and controlled within the firm. These theories are used to help identify mode choice when firms internationalize. When discussing internalization in the context of JVs, we use the term more generally, compared to the way it is used in internalization theory. Consistent with Meschi (2009), we use "JV internalization" to refer to the acquisition of the JV by a partner firm, who turns it into a WOS.

This scenario is important for strategy scholars, as it provides a micro-analytic view of competition and mode change. Several constructs, derived from different theoretical perspectives, can be studied and tested for how they relate to internalization at this level. To this, we add the constraint that the JVs are international (i.e., firms from different home countries partner to form the JV), and apply an institution-based view (Peng, 2002; Peng, Sun, Pinkham, & Chen, 2009; Peng, Wang, & Jiang, 2008) to study how institutions shape the internalization. Regulative, normative, and cultural-cognitive systems are considered the three pillars of institutions (Scott, 2008b). The impacts of national culture, representing the third pillar, on mode choice, performance, and switching are well-researched (Barkema & Vermeulen, 1997; Brouthers & Bamossy, 2006; Hennart & Zeng, 2002; Kogut & Singh, 1988; Pothukuchi, Damanpour, Choi, Chen, & Park, 2002). Considering regulatory pillar, the nature of governmental regulations, especially their complexity, will be a major factor (Dikova & van Witteloostuijn, 2007). However, public choice theory suggests that more regulations can breed corruption (Djankov, La Porta, Lopez-De-Silanes, & Shleifer, 2002). Because corruption can be a strong norm to follow, it can act as an institution under the normative pillar, and it serves to change the effectiveness of the regulations (Weitzel & Berns, 2006). These institutional factors can create friction in terms of one partner's trying to acquire the JV, whereas they may act as sources of competitive advantage for another. We study this issue in this chapter, and try to find out how each aspect is likely to affect whether foreign or local partners internalize the international JV (IJV).

India represents a good context for this study. Since liberalization in 1991, regulations have been reduced in many industries, and the JV is no longer a government-mandated mode of entry in most industries.

We study India after a decade of liberalization, so that the firms of interest are confident of a stable regulatory regime. Few scholars have considered India for such research (Kozhikode & Li, 2012), with more choosing to study China as a representative of developing or emerging economies. However, unlike China's communist capitalist economy, India has a democratic capitalist economy, which gives it institutional environment that is more prevalent in many other countries. Hence, the outcomes of this study may offer enhanced generalizability.

Literature Review

Considerable research has been done on JVs (Beamish & Lupton, 2009; Christoffersen, 2013). According to Parkhe (1993), most of the literature on IJVs has focused on the motives for IJV formation, partner characteristics and selection, control and conflict, and IJV stability and performance. When Parkhe (2006) reviewed the field again, the results were very similar. Knowing that the termination rate of JVs is as high as 30–70 % in various samples (Buckley & Casson, 1988; Kogut, 1989; Park & Russo, 1996), many researchers have studied JV termination, aiming to understand causal factors (Ren, Gray, & Kim, 2009; Yan & Zeng, 1999). Still, there have been very few studies exploring aspects beyond the factors leading to JV termination. One understudied aspect is the evolution/transformation of a JV into a WOS of one of the partners (Hennart, Kim, & Zeng, 1998; Kogut, 1991; Reuer & Miller, 1997; Steensma et al., 2008). Instead of branding JV termination as "failure", it can be considered as an option for growth and expansion (Kogut, 1991), with acquisition of the JV by one partner treated as the exercise of such an option (Barkema, Shenkar, Vermeulen, & Bell, 1997; Bleeke & Ernst, 1991; Dussauge, Garrette, & Mitchell, 2000; Gomes-Casseres, 1987; Hennart et al., 1998).

Uncertainties increase the costs of maintaining the JV (White & Lui, 2005), which means that a partner may acquire it in order to reduce transaction costs (Chi & Seth, 2009). Also, when the risk associated with further investment is low, the cost of acquisition is lower than benefits of the JV, and it is comparable to similar assets in the market; a partner firm may acquire the JV to completely appropriate the benefits rather than sharing them (Folta & Miller, 2002; Kogut, 1991). Acquiring the JV offers advantages over other acquisitions, because of the easier integration; effective integration is what enables acquisition success (Haspeslagh & Jemison, 1991). Because termination of a JV through acquisition by one of the parent firms means that the venture tips toward one side or the other, we study the impact of the institutional environment to understand to which side the venture is likely to lean. Therefore, we review the literature on JV termination and internalization, followed by the literature on institutions and regulations. In addition, a brief history of the institutional environment for firms in India is presented, to develop an understanding of the context of the empirical study.

JV Termination and Internalization

Theorizing on inter-organizational relationships has been based on many perspectives (Barringer & Harrison, 2000; Faulkner & De Rond, 2000). One of the most prominently used perspectives in the JV literature has been transaction cost economics (Tsang, 2000), which looks at JVs as a hybrid form of organization, between market and WOS, on the basis of the level of uncertainties prevalent (Williamson, 1991). Under the transaction costs framework, as the uncertainty resulting from market inefficiencies goes up, the preferred mode to organize the transaction changes from market to a hybrid option, and then to a WOS. However, another key theoretical perspective, based on real options, suggests that a firm would do well to invest in a JV under such circumstances, and wait for a better opportunity when the uncertainty is lower; that is, under high uncertainty, limit risk by committing less, and increase the investment when the risk is reduced (Ahsan & Musteen, 2011; Chi & Seth, 2009). This apparent conflict between the real options and transaction costs approaches is resolved with an understanding of the distinction between the uncertainties being considered. In the transaction cost approach, the uncertainty is viewed as endogenous, the type of uncertainty that the firm can reduce with investment. In the real options approach, the key uncertainty is exogenous, which cannot be affected by a firm (Folta, 1998; Folta & Miller, 2002).

Neither the transaction cost nor the real options perspective considers aspects such as trust and reciprocity in relations. The transaction cost view is based on an underlying assumption of opportunistic behavior. Game theory, however, suggests that partners benefit in the presence of mutual trust, which enriches relational capital. The typical use of transaction cost theory does not account for repeated transactions, which can be treated as an iterative prisoners' dilemma; to understand that, in a one-off game, one may act opportunistically but, in repeated games, benefits are maintained by trust and reciprocity (Axelrod, 1984; Faulkner & De Rond, 2000; Gulati, 1995). Moreover, from both the knowledge and resource-based views, trust and reciprocity are required for the firms to be able to share tacit resources, on top of the contract- mandated sharing of explicit resources between partners (Osborn & Baughn, 1990). The resource-based view suggests that, instead of considering cooperation as a middle path, it can be viewed as a way to improve sustainable competitive advantage by gaining from resource combination (Das & Teng, 2000b; Kimber & Raghunath, 2001; Tsang, 2000). In fact, the relationship itself can be considered as a resource that contributes to competitive advantage (Madhok, 2000; Madhok & Tallman, 1998). The organization learning perspective suggests that JV destabilization may be the result of one partner's having won the "learning race" and gained its desired level of knowledge from the relationship (Hamel, 1991). Considering property rights, the formation of the JV entailed partners' each investing less than what would have been required for complete ownership (Ramanathan, Seth, & Thomas, 1997). Once the value that can be appropriated by acquiring full ownership property rights exceeds their cost, for one partner, internalization is the logical strategy.

JV termination stems from instability. Research in this area has often considered stability as representing performance (Parkhe, 1993; Ren et al., 2009). Studies on termination have tended to focus on longevity, specifically JV duration (Dussauge et al., 2000; Hennart et al., 1998). Upon termination, JVs are necessarily either dissolved or acquired (Das & Teng, 2000a; Park & Ungson, 1997). From studies related to JV termination, some prominent factors considered are bargaining power, commitment, control, trust, justice, conflict, cooperation, cultural differences, goal congruity, external environment, and parent characteristics (Ren et al., 2009; Yan & Zeng, 1999).

Yan and Gray (1994, p. 1480) define bargaining power as "a bargainer's ability to favorably change the bargaining set, to win accommodations from the other party, and to influence the outcome of a negotiation". Firms engaging in JVs have different strategic objectives and strengths (Harrigan & Newman, 1990). In an operational JV, partner firms depend on each other's resource contributions; if one partner contributes some "irreplaceable" resource, this creates a strong dependency on the part of the other partner(s), and the contributor of that key resource gains power (Inkpen & Beamish, 1997; Yan & Gray, 1994). The factors influencing the bargaining power of JV parents include government suasion, technology, local knowledge and marketing skills, and the distribution of outputs and financial capital (Blodgett, 1991). Foreign partner bargaining power may be curtailed by host country laws (Gomes-Casseres, 1990; Nakamura, 2005; Patibandla, 2006; Puck, Holtbrügge, & Mohr, 2009). Based on examples from Abegglen and Stalk (1985), Nakamura (2005) suggested that the nature of changes in bargaining power, for local or foreign parents, may provide insights into the eventual acquirer of the JV. A firm will logically acquire the JV only if the associated integration, negotiation, and switching costs are lower than for alternative firms in the local market. When both of the parties do not share the interest in terminating the JV, the initiator will have to bear heavier switching costs, since the other partner is not ready to leave the partnership and hence is motivated to demand more for its share (Chi, 2000; Chi & Seth, 2009; Franko, 1971).

Puck et al. (2009) studied the factors behind the foreign partner's acquiring IJVs in China, using transaction cost theory (including the knowledge perspective) and institutional theory and considering asset specificity, external uncertainty, and cultural distance. Building on the Steensma and Lyles (2000) consideration of JV stability, Steensma et al., (2008) used the social exchange and organization learning perspectives, and identified power imbalance, learning from the foreign parent, and conflict between parents as the main contributors to both JV's turning into WoSs and also to whether the WOS becomes foreign or local.

Institutions

Apart from the way people casually converse about institutions, scholars in the field of sociology, economics, and political science use specific definitions. 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". These rules can be either formal (e.g., regulations, laws, constitutions, property rights) or informal (e.g., customs, norms, traditions). According to Scott (2008a, p. 48) "Institutions are comprised of regulative, normative and cultural-cognitive elements that, together with associated activities and resources, provide stability and meaning to social life". According to Schotter (1981, p. 11) "A social institution is a regularity in social behavior that is agreed to by all members of society, specifies behavior in specific recurrent situations, and is either self-policed or policed by some external authority".

While many other scholars have provided defined institutions, most definitions are in line with these three. The common notion underlying the definitions is that they seek to make the behaviors of individuals and organizations predictable (Crawford & Ostrom, 1995; Greif, 2006), through formal rules or informal norms that groups of individuals or organizations practice and expect others to follow. Enforcement may be implicit, through the mechanisms of reputation, coordination, or control of other social benefits, or there may be formal enforcement agencies. According to Dowling and Pfeffer (1975, p. 122) "Organizations seek to establish congruence between the social values associated with or implied by their activities and the norms of acceptable behavior in the larger social system of which they are a part". That is, organizations try to follow the appropriate institutions, which control the strategy domain, including both strategies that can be used and the outcomes obtained using these strategies. Thus, institutions also control organizational opportunities.

Choice based on minimizing transaction costs represents a fundamental tenet of neo-institutional economics. Building on the Coase (1937) discussion of markets and hierarchies as alternate forms of governance, Williamson (1991) argued that transaction costs can be used to guide choices among firm-level "institutions of governance" (Williamson, 1991, p. 269; Williamson, 1998, p. 75). Davis, North, and Smorodin (1971, p. 6) defined an institutional environment as "The set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution". Any change in the institutional environment changes the comparative costs among the institutions of governance of markets, hierarchies, and hybrid modes (Williamson, 1991); this notion is key in international business research, and represents the foundation of much of the entry mode literature (Anderson & Gatignon, 1986; Brouthers, 2002; Brouthers & Hennart, 2007; Chang & Rosenzweig, 2001; Contractor & Kundu, 1998; Delios & Beamish, 1999; Delios & Henisz, 2003; Erramilli & Rao, 1993; Luo, 2001; Makino & Neupert, 2000).

Regulation

The nature of the market incentivizes firm behavior. A competitive product market pressures a firm to improve its efficiency and quality, while an inefficient labor market may facilitate the use of poor practices pertaining to employee safety. Similarly, without market pressure, firms may be lax in terms of their impact on the environment. While a competitive product market may improve the labor market over time, it may not affect environment-related concerns. Society may thus demand that governments use regulation to increase social welfare more rapidly, rather than relying on slower acting market forces (Aghion, Algan, Cahuc, & Shleifer, 2010; Mulligan & Shleifer, 2005). The state is also likely to set regulations pertaining to monopoly, collusion, and anti-trust law, in order to curtail unfair competitive practices (Posner, 1969). Along with these examples of market failure, there can be other reasons to regulate (Patibandla, 2013) with the aim of improving the nation's resources. For example, mandated domestic partnership arrangements for foreign entrants may facilitate technology transfer to domestic firms and improve the nation's foreign exchange.

Institutional Environment for Firms in India

Immediately after independence, Indians had a sense of mistrust toward businesses, especially foreign ones (Basu, 2004; Roy, 2002), especially in light of the fact that a foreign firm first came to India to trade and then conquered it, which paved the way for the country to be colonized (Dalrymple, 2015). The newly formed government favored a large bureaucracy to plan and control economic activities, rather than depending on market mechanisms. A small number of business families were dominant, and they captured the state (Bardhan, 1984; Patibandla, 2006), gaining the bulk of the available licenses for various industries. Public financial institutions provided loans, held equities without active managerial control, and also took over poorly performing units, covering the loss. The anti-foreign business sentiment in India strengthened from the 1960s until the reforms in 1991 (Bardhan, 1984; Chari & Gupta, 2008). In 1973, the Foreign Exchange Regulation Act was implemented, which allowed the government to impose strict control over foreign exchange and investments by foreign firms. Facing strong limitations, firms such as Coca Cola and IBM left India. Domestic firms had protection from foreign competition, and the dynamics of local entrepreneurship were frail, except for few pockets of the country (Patibandla, 2006). The business groups created the alternative, to compensate for the resulting institutional voids (Khanna & Palepu, 2005; Khanna & Rivkin, 2001).

These business groups opposed the advent of reforms relaxing regulations governing foreign direct investment (FDI), arguing that they lacked the technology to compete against foreign players and hence should be protected. Chari and Gupta (2008) found that influence worked in favor of domestic firms in many industries during liberalization, such that the inward FDI allowed during 1991 was selective, and was successfully prevented in highly concentrated industries. State-owned firms were particularly effective in this effort, and opposition parties argued against such liberalization as a populist ploy (Bardhan, 2005).

Following the liberalization of 1991, the capitalist market mechanism was at work in India. The liberalization was phased, with regulations relaxed in different industries over time. Previously, regulations had mandated the use of JVs to enter India in many industries (Contractor, 1990). With liberalization, the institutional environment changed, and many foreign firms altered their operation modes. Industries in which state-owned or traditional private firms were concentrated before liberalization continued to be incumbent-dominated (Alfaro & Chari, 2009).

In particular, post-reform, substantial changes appeared in the rising service sector. Industries such as telecommunications and IT experienced tremendous growth, and industries that had previously been unregulated have grown especially rapidly. The growth of the service sector is attributed to the availability of high-quality tools, because of liberalization and the expansion of the manufacturing sector (Dehejia & Panagariya, 2014).

India's political environment affected the regulatory changes. The alternating between political parties in power creates differences in patterns of public expenditure (Gerring, Kingstone, Lange, & Sinha, 2011; Sáez & Sinha, 2010). Obtaining buy-in from most parties, both supporting and opposing, to get regulations passed is difficult, and even when parties are convinced, the public may not be. This led to the defeat of last Bharatiya Janata Party (BJP) government in 2004. The United Progressive Alliance (UPA-I, the first term of the two consecutive terms for which they were elected) government understood the mandate more clearly, and invested in public expenditure accordingly. It also had pressure to do this from its allies, the leftist parties (Bhattacharyya, 2013). Arguably, the corrective steps taken led to winning a second term mandate for UPA, such that Congress, the leading party in the alliance, no longer required the left-wing support, and the policy formulations changed accordingly. However, during this second term, their supporters also opposed the reforms, fearing loss of support among their primary voter; this led to the controversy around FDI in retail, where political parties like members of the ruling alliance All India Trinamool Congress also opposed it fiercely and even threatened to withdraw support for the government (Bhattacharyya, 2013). UPA-II also appeared to lose focus on monitoring, allowing rampant corruption to continue, including scams in the 2G spectrum auction, coal block allocation, and the 2010 Commonwealth Games. These issues contributed to the poor performance of Congress and UPA in the 2014 national elections, allowing BJP to come back into power as the single largest party.

Competitors in markets use their resources to beat their rivals (Lahiri, Kedia, Raghunath, & Agrawal, 2009). Similarly, during exposés of corruption scam, it became clear that firms also used their political resources toward these ends (Heston & Kumar, 2008). Differential regulations applying to foreign and domestic competitors mean that local firms should be advantaged; it also seems that they may also have advantages in terms of political influence.

Theory

Motivating Through New Institutional Economics

Calculated choices are based on cost-benefit analysis (Ghemawat, 1991; Ghemawat & Costa, 1993). As (Milgrom & Roberts, 1990, p. 88) argued, "capitalist economic institutions are organized so as to minimize the sum of the costs of resources used in production and the costs of managing the necessary transactions". This explains the importance of transaction cost economics in the international business literature (Williamson, 2010). The work of Coase (1937) led to the establishment of the idea that the firm is a mode of governance. This led to the transaction cost theory pertaining to the boundary of the firm, which states that, if the costs of transacting in the market are high, and can be reduced by internalizing the transaction within a firm, then the firm should be the form for organizing the transaction.

This relates to *raison d'être* of markets. Markets facilitate exchange at lower cost by reducing the costs of search and information, and evolve with economies of specialization (Patibandla, 2006; Smith, 1904). Larger markets create uncertainty with regard to the enforcement of contracts, and so most are regulated, such that contracts are honored (Patibandla, 2006). Still there are costs associated with transacting in a market, including bargaining, contracting, policing, and enforcement (Dahlman, 1979). Sometimes, these costs can be reduced by bringing the transaction into the firm. Moreover, entrepreneurs often prefer to exert more control and absorb some risks, in order to invest in transaction-specific assets.

The costs of transacting are not always lower within a firm, and some transactions should be carried out in the market (Coase, 1937, 1960). Moreover, firms and markets are not the only two modes of economic organization. There are many ways in which a transaction can be organized, including long-term contracts, JVs, alliances, franchising, and licensing. Modes of economic organization are chosen based on where the transaction cost is expected to be the lowest (Williamson, 1989, 1991). This concept has also been applied to study the termination of JVs (Makino et al., 2007; Park & Russo, 1996; Pearce, 1997). It is important to note that the transaction costs that lead to mode change need not be the same as those determining the mode chosen as outcome of the change. This is reflected in the literature by two strands of research in this area: one addressing IJV instability or termination and the other looking at IJV acquisition (Puck et al., 2009; Steensma et al., 2008). We focus on the latter in this chapter.

The transaction costs involved in acquiring the JV may differ for each parent, which can affect which parent executes the acquisition. While industry-level factors will be similar, differences exist at the firm level, in terms of resources and capabilities. A key difference is associated with the firm's country of origin, and foreign and domestic firms will be affected differently by institutions. The foreign firm will be less familiar with the host country culture, and the regulations surrounding a foreign firm are different from that of a local firm. Generally, foreign firms must abide by both industry-level and foreign investment policies of the host countries, while local firms are affected only by the former. If corruption is a norm in the host country and the foreign firm's home country has anti-corruption policies extending jurisdiction over foreign subsidiaries, or the firm is from a country where corruption is not a pervasive norm, then it will be at a disadvantage.

Impact of Regulations

Institutions are "constraints that shape human interaction" (North, 1990, p. 3), and "a constraint on one person is opportunity for another" (Schmid, 2004, p. 1). Regulations about foreign investment and operations are constraints that shape the behavior of the foreign firms in a country, affecting their strategies.

Governments generally welcome FDI, in order to increase investment and bring new resources and technologies into the country. However, along with the benefits, FDI brings some potentially negative outcomes, such as harm to local firms that are unable to compete effectively against the foreign players. Over time, this can lead to foreign firms' becoming extremely powerful, raising concerns about national security and sovereignty, leading governments to create restrictions in terms of FDI regulations that include ownership restrictions such as the requirement to have a local partner (Chen, Paik, & Park, 2010). In such a situation, the foreign partner will be prevented from internalizing a JV, but will need to either find another local partner or else go public. Such constraints benefit the local partner. Even though the resources of the foreign firm may be superior, the local partner has an advantage in terms of acquiring the JV.

Local laws that are complex and strongly regulatory encourage foreign firms to choose IJV as an entry mode (Yiu & Makino, 2002). In highly regulated environments, the foreign partner is likely to prefer not to change the JV into a WOS, and may seek another JV partner (Puck et al., 2009), to maintain legitimacy and lower transaction costs associated with handling the regulatory environment (Xu & Shenkar, 2002).

Strongly nationalist sentiment among the public may affect the host country government's attitude toward regulation, giving it enhanced bargaining power that the local partner can use to its advantage (Gomes-Casseres, 1990; Yiu & Makino, 2002). As discussed earlier, regulatory protection has long been available to Indian firms in many industries, and nationalist sentiments regularly nudge the government to continue this stance. During the liberalization of FDI, the most regulated industries were among the last to be opened to foreign competition (Chari & Gupta, 2008). Even after almost 15 years of liberalization, the situation has not changed in many industries, especially those in which state-owned enterprises and business groups dominated before the reforms; this is despite the increased participation of foreign firms (Alfaro & Chari, 2009). In terms of regulations and lobbying power, foreign firms remain disadvantaged, giving them incentive to find other partners in the event of the termination of a JV. Thus, we hypothesize:

Hypothesis 1 In industries with higher regulation, the likelihood of the local partner's acquiring the IJV upon termination is higher.

Impact of International Trade Relationships

In 2012, India experienced a large scandal related to the distribution of 2G licenses. As a remedial step, the government canceled the licenses of operators that had obtained their licenses in that distribution round. Among those affected was a JV between a local company and Telenor, a Norwegian company. Telenor took legal action, and also arranged for the Norwegian IT minister to come to India, and meet with Indian counterparts to negotiate.

We expect the home countries of foreign partners to help them to negotiate in the host country, especially for firms in which the home country has some ownership. Such negotiations are arguably more likely to be effective work if the host country views itself as dependent, in terms of trade, on the foreign firm's home country, conferring stronger bargaining power.

Hypothesis 2 If the host country is dependent on the home country of the foreign partner in terms of trade relations, then the likelihood of the foreign partner's acquiring the IJV is higher.

Impact of Corruption

Corruption is generally viewed as having a negative impact on inward FDI (Smarzynsk & Wei, 2002). It also affects the entry mode choices of foreign firms (Uhlenbruck, Rodriguez, Doh, & Eden, 2006) and the partnership criteria used for IJVs (Roy & Oliver, 2009). Institutional theory supports the notion that a foreign firm can gain legitimacy by partnering with a local firm (Chan & Makino, 2007), which will help the foreign firm to gain the local knowledge necessary to, among other issues, find alternatives to circumventing the constraints posed by corruption. On the other hand, highly pervasive corruption may lead a foreign firm to avoid equity partnerships, in order to reduce the bargaining power of local partners (Uhlenbruck et al., 2006). Relatedly, Delios and Henisz (2000) found that the equity ownership held by foreign firms is dependent on expropriation hazards, both public and private.

In highly regulated environments, political strategies assume greater importance (Djankov et al., 2002). As the foreign partner has already entered the host country through the IJV, it can be assumed to have some understanding of the practices pertaining to corruption in that environment, and may not want to exit the country following the break-up. Still, local firms have advantages, in terms of their networks with bureaucrats and politicians (Hiatt & Park, 2013). More specifically, it is logical to assume that foreign firms from countries with levels of corruption similar to India's will cope more easily and thus be more comfortable with internalizing the JV. The difference in corruption level between the host and home countries will affect the amount of expertise the foreign firm will have to gain with respect to corruption in the host environment (Spencer & Gomez, 2011). Faced with a large difference, the foreign firm may find it more unattractive to deal with corruption (Cuervo-Cazurra, 2006), and opt to ally with a local partner. For example, in the 2G spectrum auction scandal, the direct participants in the act of corruption were local firms. Though the foreign partners lost those licenses upon investigation and ruling by the court of law, the risk of prosecution due to the corrupt actions was completely assumed by the local partner. Based on this, we hypothesize:

Hypothesis 3 The higher the corruption levels in the host country, relative to the home country of the foreign partner, the greater the likelihood of the local partner's internalizing the IJV.

Methodology

Sample

Data for applicable IJVs in India were obtained from the Thomson SDC (Securities Data Corporation) Platinum database, supplemented by other sources such as the Thomson One banker and Prowess databases and company websites. The JVs considered have at least one Indian parent firm. JV data for the period of 2002 through 2012 were examined, and yielded 174 JV acquisitions, of which 40 were fully domestic JVs.

To avoid the confounding effect of the strategic exit of one partner's leading to acquisition of the JV by the other partner, we checked to see if both of the parents had continued in the same industry in India, after the acquisition, using registration details, company annual reports, and corporate websites, along with news articles included in Lexis-Nexis. A lack of evidence that a firm had continued its operation in the same industry in India was taken as indicative of a strategic exit from the industry having driven the acquisition of the IJV by the other partner; such cases were not included in the analysis. Finally, in 62 of the 134 terminated IJVs, both parents continued in the same industry in India after the acquisition. These 62 firms comprise our sample.

Of the 62 events in the sample, the Indian partner acquired the JV upon termination in 23 cases. For these cases, we also verified that the foreign partners did not have any foreign investment-related regulation prohibiting them from acquiring the JV.

The dependent variable is binary, taking the value of 1 if the local partner internalized the IJV upon termination, and 0 otherwise. As the dependent variable is binary, we use conditional logistic regression, with fixed effects for the year of IJV termination.

The explanatory variable used to test Hypothesis 1 is binary, with a value of 1 for highly regulated industries and 0 for others, based on data from Department of Industrial Policy and Promotion of the Government of India. A similar classification is available for US firms, and is in wide use (Grier, Munger, & Roberts, 1994; Hadani & Schuler, 2013). The categorization was done by creating an index that aggregated eight ordering schemes: Pittman's (1977) seminal work on classifying regulated industries in the USA, the Chakraborty and Nunnenkamp (2008) analysis of FDI intensity in India, the Das (2003) results on effective rate of protection in the manufacturing sector in India, *The Economist* (2014) classification for crony capitalism, trade policy data on restrictions on export/import, the presence of an industry regulatory body, the presence of the government as a major buyer or supplier, and whether industry belongs to the natural resource or infrastructure sector. The cataloging was based on two-digit NIC code, and the use of Indian data revealed several differences from the US coding.

For Hypotheses 2 and 3, country-level variables pertaining to India and the home country of the foreign partner are included. The amount of trade (as a percentage of total trade in India in the year of the internalization) between the two countries, per UNCTAD, is used to test Hypothesis 2. As this measure is a proportion, a logit transformation ($ln(x/(1–x))$) is used before including it in the regression, for improved interpretation of the results. For Hypothesis 3, the difference in corruption levels is measured based on Transparency International's corruption perception index.

Several control variables are included in the regression modeling. At the inter-country relationship level, we control for diplomatic affinity of nations (Voeten, Strezhnev, & Bailey, 2015), operationalized using an index that shows the similarity in voting positions of two countries in the United Nations General Assembly, reflecting diplomatic closeness. Cultural distance is operationalized using data from the GLOBE study (Waldman et al., 2006) and the approach of Kogut and Singh (1988). Three cases involving foreign firms from countries for which GLOBE data were not available were dropped from the sample. At the firm level, we control for the India-specific experience of the foreign firm, based on annual reports, company websites, news articles from Lexis-Nexis and Google, and, if necessary, the registrar of companies website. We also controlled for the owner business group (if any) of the Indian partner and the group size, using a composite variable from the Centre for Monitoring Indian Economy Pvt. Ltd. (CMIE) Prowess database. The owner groups are classified by CMIE as private Indian standalone firms, government-owned firms, top 50 business houses, large business houses (120 business groups that are smaller than the top 50, in terms of revenue) and other business houses. Data were unavailable for nine local firms, through the Prowess database; these firms were dropped from the analysis. Two additional observations were dropped because of duplicate entries.

Results

The descriptive statistics of all the variables are provided in Table 5.1, and the correlations between pairs of the non-categorical explanatory variables are provided in Table 5.2. Since there are some strong correlations detected, we present the variance inflation factor (VIF) statistics for the

Table 5.1 Descriptive statistics

Variable	Mean	Std. Dev.	Min	Max
Acquirer	0.42	0.50	0	1
Experience of the foreign firm	23.50	29.50	3	150
Trade (logit transformation)	−3.47	1.54	−11.52	−1.86
CPI score difference	4.03	1.36	0	6.20
Affinity of Nations index	−0.02	0.46	−0.64	0.81
Cultural distance (GLOBE)	1.77	0.78	0	3.79
Highly regulated industries	0.40	0.50	0	1
Owner groups				
Top 50 business houses	0.40	0.505	0	1
Large business houses	0.15	0.36	0	1
Other business houses	0.29	0.46	0	1
Private (Indian) firms	0.12	0.32	0	1

Table 5.2 Correlations among non-categorical variables

	Experience of the foreign firm	Trade (logit transformation)	CPI score difference	Affinity of Nations index
Trade (logit transformation)	0.09			
CPI score difference	0.10	0.26*		
Affinity of Nations index	−0.11	−0.52**	0.12	
Cultural distance (GLOBE)	0.02	0.06	0.58**	0.29*

**p*<0.05, ***p*<0.01

explanatory variables in Table 5.3, which shows that there are no issues of problem multicollinearity present in the model. The results of the regression modeling are presented in Table 5.4.

Among the control variables, the foreign firm's experience in India is found to add significant ($p<0.10$) explanatory power, suggesting that foreign firms with greater experience in India are more likely to concede their shares in the IJV to the local parent. Hypothesis 1 finds support from the finding that the likelihood of the local parent's acquiring the IJV is significantly ($p<0.10$) higher within highly regulated industries. Hypotheses 2 and 3 are not supported, as the coefficients associated with the difference in corruption levels between India and the home country of the foreign parent and the trade relationship.

Table 5.3 VIF values

Variable	VIF	Tolerance	R^2
Experience of the foreign firm	1.10	0.91	0.09
Trade (logit transformation)	1.86	0.54	0.47
CPI score difference	1.57	0.64	0.37
Affinity of Nations index	1.74	0.57	0.43
Cultural distance (GLOBE)	1.49	0.67	0.33
Highly regulated industries	1.12	0.89	0.11
Owner groups	1.15	0.87	0.13

Table 5.4 Conditional logistic regression with fixed effects for the year of IJV termination

DV: Partner internalizing the IJV	
Experience of the foreign firm	0.05^+
	(1.66)
Trade (logit transformation)	−0.86
	(−1.23)
CPI score difference	0.20
	(0.46)
Affinity of Nations index	−2.73
	(−1.60)
Cultural distance (GLOBE)	0.42
	(0.56)
Highly regulated industries	1.45^+
	(1.70)
Large business houses	17.07
	(0.01)
Other business houses	17.39
	(0.01)
Private (Indian)	18.89
	(0.01)
Top 50 business houses	17.01
	(0.01)
Pseudo R^2	0.36
AIC	48.90
BIC	68.02
Log-likelihood	−14.45
χ^2	16.02^+

$^+p<0.10$, $n = 50$, t statistics in parentheses

Discussion

Studying impact of corruption on acquisitions made by foreign firms, Weitzel and Berns (2006) argued that corruption reduces the premium paid by reducing synergy. Meschi (2009) found that, with reduced corruption, foreign firms are more likely to try to internalize an IJV. However, these findings were observed only when corruption was operationalized using the Political Risk Services (PRS) International Country Risk Guide corruption index, and not for the Transparency International ratings.

In this study, we add to the literature by shifting the focus to regulation at the industry level in the IJV's host country, while filtering out the situation in which a partner left the IJV willingly as part of change in corporate strategy by checking to see if the selling parent continued in the same industry during the year after the dissolution of the IJV. While the difference in corruption levels between India and the foreign partner's home country did not offer significant explanatory power in our model, this should not be interpreted as implying that corruption does not affect the internalization decision. As the odds of an IJV in a highly regulated industry being acquired by the local parent are significantly higher, we can infer that corruption does play a role. According to the public choice perspective, higher regulation indicates higher scope for rent-seeking behavior (Buchanan, 1980; Krueger, 1974; Mudambi, Navarra, & Delios, 2013; Tollison, 1982; Tullock, 1967) and thus presents higher likelihood for the public office to be captured for rent-seeking (Dal Bó, 2006; Stigler, 1971). Hence, we can expect that highly regulated industries in India are more likely to be administered by public offices that are subject to corrupt practices. In such a case, the local firm will have an advantage over the foreign firm, being more familiar with the process of capturing these offices. Third-party political and public affairs consultants can provide such know-how to foreign firms, and might also offer their services to complete the process of capture as an outsourcing solution, as was done by Vaishnavi Communications in the case of the 2G spectrum auction scam discussed above. Still, local firms can be expected to have longer term and stronger ties with the politicians and bureaucrats at key public offices. If the corruption in such offices is arbitrary (Lee, Oh, & Eden, 2010; Rodriguez, Uhlenbruck, & Eden, 2005; Uhlenbruck et al., 2006), then the third-party solutions may work for foreign firms. Otherwise, the historical and strong relationships should be of more value to local firms. Hence, our results provide a hint that highly regulated industries in India might be corrupt and, if so, the corruption is not arbitrary in nature.

In the relatively small dataset used for this study, there are no firms from countries with corruption scores lower than that of India, according to Transparency International. In light of those scores, the above inference about the possibility of highly regulated industries in India's being corrupt seems plausible. However, the small dataset limited the scope to estimate the impact of the difference in corruption levels between countries. Future work, using a larger sample with a variety of host countries will be useful, and may allow effects of other country-level variables, such as trade and diplomatic affinity between nations, to be investigated in more depth.

Our model has addressed only the impact on competition between foreign and local firms. As noted earlier, the strength of political ties may also affect competition, especially between local firms, and should be studied in scenarios of such close competition for resources. For managers working in India, corporate political strategies are important. Our results reinforce the notion that political strategies need to be fine-tuned, according to the nature of the industry in which the firm operates. In less regulated industries, the importance of political ties should be reduced. Firms should always act with caution and proper due diligence.

Measuring the level of industry regulation can be complex. There are multiple dimensions, such as ownership limitations, reporting requirements, and copyright protection strength, along which the level of regulation across industries differs. Our rather simplistic use of a binary categorization to represent the industry's level of regulation represents a limitation of this study and gives scope for further research to create a detailed index of regulation across industries and study its impact.

We have also made some strong assumptions regarding the limited effectiveness of lobbying by foreign firms. In practice, the scenario may be different. Foreign firms do have some room to lobby, based on the technology they bring and the new jobs they create. However, following Alfaro and Chari (2009), state-owned enterprises and traditional private firms still dominate industries in India. Hence, lobbying by foreign firms can be expected to fall short in comparison to the efforts of the incumbents (Alfaro & Chari, 2009; , 2008). More direct studies that test this assumption will be useful.

Broadly, this chapter has focused on the competition between foreign and local firms. However, competition is looked at in chapter paper at the micro level between only the foreign and local firm that were erstwhile IJV partners, with respect to internalizing the IJV upon its termination. In this way, we concentrate on competition upon mode change, and provide insights about the impact of the institutional environment on the outcome of that competition.

References

Abegglen, J. C., & Stalk, G. (1985). *Kaisha, the Japanese corporation*. New York: Basic Books.

Aghion, P., Algan, Y., Cahuc, P., & Shleifer, A. (2010). Regulation and distrust. *The Quarterly Journal of Economics, 125*(3), 1015–1049.

Ahsan, M., & Musteen, M. (2011). Multinational enterprises' entry mode strategies and uncertainty: A review and extension. *International Journal of Management Reviews, 13*(4), 376–392.

Alfaro, L., & Chari, A. (2009). India transformed? Insights from the firm level 1988–2005. In S. Bery, B. Bosworth, & A. Panagariya (Eds.), *India policy forum 2009–10*. New Delhi, India: The Brookings Institution.

Anderson, E., & Gatignon, H. (1986). Modes of foreign entry: A transaction cost analysis and propositions. *Journal of International Business Studies, 17*(3), 1–26.

Anonymous. (2014). Planet plutocrat; our crony-capitalism index, *The Economist*. London: The Economist Intelligence Unit N.A., Incorporated.

Axelrod, R. (1984). *The evolution of cooperation*. New York: Basic Books.

Bardhan, P. K. (1984). *The political economy of development in India*. Delhi: Oxford University Press.

Bardhan, P. K. (2005). Nature of opposition to economic reforms in India. *Economic and Political Weekly*, *40*(48), 4995–4998.

Barkema, H. G., Shenkar, O., Vermeulen, F., & Bell, J. H. J. (1997). Working abroad, working with others: How firms learn to operate international joint ventures. *Academy of Management Journal, 40*(2), 426–442.

Barkema, H. G., & Vermeulen, F. (1997). What differences in the cultural backgrounds of partners are detrimental for international joint ventures? *Journal of International Business Studies, 28*(4), 845–864.

Barringer, B. R., & Harrison, J. S. (2000). Walking a tightrope: Creating value through interorganizational relationships. *Journal of Management, 26*(3), 367–403.

Basu, K. (2004). The Indian economy: Up to 1991 and since. In K. Basu (Ed.), *India's emerging economy–performance and prospects in the 1990s and beyond*. New Delhi: Oxford University Press.

Beamish, P. W., & Lupton, N. C. (2009). Managing joint ventures. *Academy of Management Perspectives, 23*(2), 75–94.

Bhattacharyya, S. (2013). *Two decades of market reform in India: Some dissenting views*. New York: Anthem Press.

Bleeke, J., & Ernst, D. (1991). The way to win in cross-border alliances. *Harvard Business Review, 69*(6), 127–135.

Blodgett, L. L. (1991). Partner contributions as predictors of equity share in international joint ventures. *Journal of International Business Studies, 22*(1), 63–78.

Brouthers, K. D. (2002). Institutional, cultural and transaction cost influences on entry mode choice and performance. *Journal of International Business Studies, 33*(2), 203–221.

Brouthers, K. D., & Bamossy, G. J. (2006). Post-formation processes in eastern and western European joint ventures. *Journal of Management Studies, 43*(2), 203–229.

Brouthers, K. D., & Hennart, J.-F. (2007). Boundaries of the firm: Insights from international entry mode research. *Journal of Management, 33*(3), 395–425.

Buchanan, J. M. (1980). Rent seeking and profit seeking. In J. M. Buchanan, R. D. Tollison, & G. Tullock (Eds.), *Toward a theory of the rent-seeking society*. College Station, TX: Texas A&M University.

Buckley, P. J., & Casson, M. (1988). A theory of cooperation in international business. In F. J. Contractor & P. Lorange (Eds.), *Cooperative strategies in international business*. New York: Free Press.

Chakraborty, C., & Nunnenkamp, P. (2008). Economic reforms, FDI, and economic growth in India: A sector level analysis. *World Development, 36*(7), 1192–1212.

Chan, C. M., & Makino, S. (2007). Legitimacy and multi-level institutional environments: Implications for foreign subsidiary ownership structure. *Journal of International Business Studies, 38*(4), 621–638.

Chang, S.-J., & Rosenzweig, P. M. (2001). The choice of entry mode in sequential foreign direct investment. *Strategic Management Journal, 22*(8), 747–776.

Chari, A., & Gupta, N. (2008). Incumbents and protectionism: The political economy of foreign entry liberalization. *Journal of Financial Economics, 88*(3), 633–656.

Chen, D., Paik, Y., & Park, S. H. (2010). Host-country policies and mne management control in IJVs: Evidence from China. *Journal of International Business Studies, 41*(3), 526–537.

Chi, T. (2000). Option to acquire or divest a joint venture. *Strategic Management Journal, 21*(6), 665–687.

Chi, T., & Seth, A. (2009). A dynamic model of the choice of mode for exploiting complementary capabilities. *Journal of International Business Studies, 40*(3), 365–387.

Christoffersen, J. (2013). A review of antecedents of international strategic alliance performance: Synthesized evidence and new directions for core constructs. *International Journal of Management Reviews, 15*(1), 66–85.

Coase, R. H. (1937). The nature of the firm. *Economica, 4*(16), 386–405.

Coase, R. H. (1960). The problem of social cost. *Journal of Law and Economics, 3*(1), 1–44.

Contractor, F. J. (1990). Ownership patterns of U.S. joint ventures abroad and the liberalization of foreign government regulations in the 1980s: Evidence from the benchmark surveys. *Journal of International Business Studies, 21*(1), 55–73.

Contractor, F. J., & Kundu, S. K. (1998). Modal choice in a world of alliances: Analyzing organizational forms in the international hotel sector. *Journal of International Business Studies, 29*(2), 325–357.

Crawford, S. E. S., & Ostrom, E. (1995). A grammar of institutions. *The American Political Science Review, 89*(3), 582–600.

Cuervo-Cazurra, A. (2006). Who cares about corruption? *Journal of International Business Studies, 37*(6), 807–822.

Dahlman, C. J. (1979). The problem of externality. *Journal of Law and Economics, 22*(1), 141–162.

Dal Bó, E. (2006). Regulatory capture: A review. *Oxford Review of Economic Policy, 22*(2), 203–225.

Dalrymple, W. (2015). The east india company: The original corporate raiders. *The Guardian*. March 4, 2015.

Das, D. K. (2003). *Quantifing trade barriers: Has protection declined substantially in Indian manufacturing?* ICRIER working paper (105).
Das, T. K., & Teng, B.-S. (2000a). Instabilities of strategic alliances: An internal tensions perspective. *Organization Science, 11*(1), 77–101.
Das, T. K., & Teng, B.-S. (2000b). A resource-based theory of strategic alliances. *Journal of Management, 26*(1), 31–61.
Davis, L. E., North, D. C., & Smorodin, C. (1971). *Institutional change and American economic growth*. New York: CUP Archive.
Dehejia, R. H., & Panagariya, A. (2014). *Trade liberalization in manufacturing and accelerated growth in services in India*. Cambridge, MA: National Bureau of Economic Research.
Delios, A., & Beamish, P. W. (1999). Ownership strategy of Japanese firms: Transactional, institutional, and experience influences. *Strategic Management Journal, 20*(10), 915–933.
Delios, A., & Henisz, W. J. (2000). Japanese firms' investment strategies in emerging economies. *Academy of Management Journal, 43*(3), 305–323.
Delios, A., & Henisz, W. J. (2003). Political hazards, experience, and sequential entry strategies: The international expansion of Japanese firms, 1980–1998. *Strategic Management Journal, 24*(11), 1153–1164.
Dikova, D., & van Witteloostuijn, A. (2007). Foreign direct investment mode choice: Entry and establishment modes in transition economies. *Journal of International Business Studies, 38*(6), 1013–1033.
Djankov, S., La Porta, R., Lopez-De-Silanes, F., & Shleifer, A. (2002). The regulation of entry. *Quarterly Journal of Economics, 117*(1), 1–37.
Dowling, J., & Pfeffer, J. (1975). Organizational legitimacy: Social values and organizational behavior. *The Pacific Sociological Review, 18*(1), 122–136.
Dussauge, P., Garrette, B., & Mitchell, W. (2000). Learning from competing partners: Outcomes and durations of scale and link alliances in Europe, North America and Asia. *Strategic Management Journal, 21*(2), 99–126.
Dunning, J. H. (2003). Some antecedents of internalization theory. *Journal of International Business Studies*, *34*(2), 108–115.
Erramilli, M. K., & Rao, C. P. (1993). Service firms' international entry-mode choice: A modified transaction-cost analysis approach. *Journal of Marketing, 57*(3), 19–38.
Faulkner, D. O., & De Rond, M. (2000). Perspectives on cooperative strategy. In D. O. Faulkner & M. De Rond (Eds.), *Cooperative strategy: Economic, business, and organizational issues*. Oxford: Oxford University Press.

Folta, T. B. (1998). Governance and uncertainty: The trade-off between administrative control and commitment. *Strategic Management Journal, 19*(11), 1007–1028.

Folta, T. B., & Miller, K. D. (2002). Real options in equity partnerships. *Strategic Management Journal, 23*(1), 77–88.

Franko, L. C. (1971). Joint venture divorce in the multinational company. *Columbia Journal of World Business, 6*(3), 13–22.

Gerring, J., Kingstone, P., Lange, M., & Sinha, A. (2011). Democracy, history, and economic performance: A case-study approach. *World Development, 39*(10), 1735–1748.

Ghemawat, P. (1991). *Commitment: The dynamic of strategy*. New York: Free Press.

Ghemawat, P., & Costa, J. E. R. I. (1993). The organizational tension between static and dynamic efficiency. *Strategic Management Journal, 14*, 59–73.

Gomes-Casseres, B. (1987). Joint venture instability: Is it a problem? *Columbia Journal of World Business, 22*(2), 97–102.

Gomes-Casseres, B. (1990). Firm ownership preferences and host government restrictions: An integrated approach. *Journal of International Business Studies, 21*(1), 1–22.

Greif, A. (2006). *Institutions and the path to the modern economy: Lessons from medieval trade*. Cambridge: Cambridge University Press.

Grier, K. B., Munger, M. C., & Roberts, B. E. (1994). The determinants of industry political activity, 1978–1986. *The American Political Science Review, 88*(4), 911–926.

Gulati, R. (1995). Does familiarity breed trust? The implications of repeated ties for contractual choice in alliances. *Academy of Management Journal, 38*(1), 85–112.

Hadani, M., & Schuler, D. A. (2013). In search of El Dorado: The elusive financial returns on corporate political investments. *Strategic Management Journal, 34*(2), 165–181.

Hamel, G. (1991). Competition for competence and interpartner learning within international strategic alliances. *Strategic Management Journal, 12*(S1), 83–103.

Harrigan, K. R., & Newman, W. H. (1990). Bases of interorganization co operation: Propensity, power, persistence. *Journal of Management Studies, 27*(4), 417–434.

Haspeslagh, P. C., & Jemison, D. B. (1991). *Managing acquisitions: Creating value through corporate renewal*. New York: Free Press.

Hennart, J.-F., Kim, D.-J., & Zeng, M. (1998). The impact of joint venture status on the longevity of Japanese stakes in U.S. manufacturing affiliates. *Organization Science, 9*(3), 382–395.

Hennart, J.-F., & Zeng, M. (2002). Cross-cultural differences and joint venture longevity. *Journal of International Business Studies, 33*(4), 699–716.

Heston, A., & Kumar, V. (2008). Institutional flaws and corruption incentives in India. *Journal of Development Studies, 44*(9), 1243–1261.

Hiatt, S. R., & Park, S. (2013). Lords of the harvest: Third-party influence and regulatory approval of genetically modified organisms. *Academy of Management Journal, 56*(4), 923–944.

Inkpen, A. C., & Beamish, P. W. (1997). Knowledge, bargaining power, and the instability of international joint ventures. *Academy of Management Review, 22*(1), 177–202.

Khanna, T., & Palepu, K. (2005). The evolution of concentrated ownership in India: Broad patterns and a history of the Indian software industry. In R. K. Morck (Ed.), A *history of corporate governance around the world: Family business groups to professional managers*. Chicago: University of Chicago Press.

Khanna, T., & Rivkin, J. W. (2001). Estimating the performance effects of business groups in emerging markets. *Strategic Management Journal*, *22*(1), 45–74.

Kimber, D., & Raghunath, S. (2001). Discovering the needle of trust in the haystack of distrust. *Journal of Corporate Citizenship, 2001*(4), 63–78.

Kogut, B. (1989). The stability of joint ventures: Reciprocity and competitive rivalry. *The Journal of Industrial Economics, 38*(2), 183–198.

Kogut, B. (1991). Joint ventures and the option to expand and acquire. *Management Science, 37*(1), 19–33.

Kogut, B., & Singh, H. (1988). The effect of national culture on the choice of entry mode. *Journal of International Business Studies, 19*(3), 411–432.

Kozhikode, R. K., & Li, J. (2012). Political pluralism, public policies, and organizational choices: Banking branch expansion in India, 1948–2003. *Academy of Management Journal, 55*(2), 339–359.

Krueger, A. O. (1974). The political economy of the rent-seeking society. *The American Economic Review, 64*(3), 291–303.

Lahiri, S., Kedia, B. L., Raghunath, S., & Agrawal, N. M. (2009). Anticipated rivalry as a moderator of the relationship between firm resources and performance. *International Journal of Management, 26*(1), 146–158.

Lee, S.-H., Oh, K., & Eden, L. (2010). Why do firms bribe? *Management International Review, 50*(6), 775–796.

Luo, Y. (2001). Determinants of entry in an emerging economy: A multilevel approach. *Journal of Management Studies, 38*(3), 443–472.

Madhok, A. (2000). Transaction (in) efficiency, value (in) efficiency, and interfirm collaboration. In D. O. Faulkner & M. De Rond (Eds.), *Cooperative strategy: Economic, business and organizational issues*. Oxford: Oxford University Press.

Madhok, A., & Tallman, S. B. (1998). Resources, transactions and rents: Managing value through interfirm collaborative relationships. *Organization Science, 9*(3), 326–339.

Makino, S., Chan, C. M., Isobe, T., & Beamish, P. W. (2007). Intended and unintended termination of international joint ventures. *Strategic Management Journal, 28*(11), 1113–1132.

Makino, S., & Neupert, K. E. (2000). National culture, transaction costs, and the choice between joint venture and wholly owned subsidiary. *Journal of International Business Studies, 31*(4), 705–713.

Meschi, P.-X. (2009). Government corruption and foreign stakes in international joint ventures in emerging economies. *Asia Pacific Journal of Management, 26*(2), 241–261.

Milgrom, P., & Roberts, J. (1990). Bargaining costs, influence costs, and the organization of economic activity. In J. Alt & K. Shepsle (Eds.), *Perspectives on positive political economy*. Cambridge University Press: Cambridge.

Mudambi, R., Navarra, P., & Delios, A. (2013). Government regulation, corruption, and FDI. *Asia Pacific Journal of Management, 30*(2), 487–511.

Mulligan, C. B., & Shleifer, A. (2005). The extent of the market and the supply of regulation. *Quarterly Journal of Economics, 120*(4), 1445–1473.

Nakamura, M. (2005). Joint venture instability, learning and the relative bargaining power of the parent firms. *International Business Review, 14*(4), 465–493.

North, D. C. (1990). *Institutions, institutional change and economic performance*. Cambridge: Cambridge University Press.

Osborn, R. N., & Baughn, C. C. (1990). Forms of interorganizational governance for multinational alliances. *Academy of Management Journal, 33*(3), 503–519.

Park, S. H., & Russo, M. V. (1996). When competition eclipses cooperation: An event history analysis of joint venture failure. *Management Science, 42*(6), 875–890.

Park, S. H., & Ungson, G. R. (1997). The effect of national culture, organizational complementarity, and economic motivation on joint venture dissolution. *Academy of Management Journal, 40*(2), 279–307.

Parkhe, A. (1993). "Messy" research, methodological predispositions, and theory development in international joint ventures. *Academy of Management Review, 18*(2), 227–268.

Parkhe, A. (2006). Research methods in alliances. In O. Shenkar & J. J. Reuer (Eds.), *Handbook of strategic alliances*. Thousand Oaks, CA: SAGE Publications.

Patibandla, M. (2006). *Evolution of markets and institutions: A study of an emerging economy*. London: Routledge.

Patibandla, M. (2013). New institutional economics: Its relevance to curbing corruption. *Economic and Political Weekly, 48*(9), 55–63.

Pearce, R. J. (1997). Toward understanding joint venture performance and survival: A bargaining and influence approach to transaction cost theory. *Academy of Management Review, 22*(1), 203–225.

Peng, M. W. (2002). Towards an institution-based view of business strategy. *Asia Pacific Journal of Management, 19*(2), 251–267.

Peng, M. W., & Shenkar, O. (2002). Joint venture dissolution as corporate divorce. *Academy of Management Executive, 16*(2), 92–105.

Peng, M. W., Sun, S. L., Pinkham, B., & Chen, H. (2009). The institution-based view as a third leg for a strategy tripod. *Academy of Management Perspectives, 23*(3), 63–81.

Peng, M. W., Wang, D. Y. L., & Jiang, Y. (2008). An institution-based view of international business strategy: A focus on emerging economies. *Journal of International Business Studies, 39*(5), 920–936.

Pittman, R. (1977). Market structure and campaign contributions. *Public Choice, 31*(1), 37–52.

Posner, R. A. (1969). Natural monopoly and its regulation. *Stanford Law Review, 21*(3), 548–643.

Pothukuchi, V., Damanpour, F., Choi, J., Chen, C. C., & Park, S. H. (2002). National and organizational culture differences and international joint venture performance. *Journal of International Business Studies, 33*(2), 243–265.

Puck, J. F., Holtbrügge, D., & Mohr, A. T. (2009). Beyond entry mode choice: Explaining the conversion of joint ventures into wholly owned subsidiaries in the People's Republic of China. *Journal of International Business Studies, 40*(3), 388–404.

Raghunath, S. (1998). Joint ventures: Does termination mean failure? *IIMB Management Review, 10*, 11–17.
Ramanathan, K., Seth, A., & Thomas, H. (1997). Explaining joint ventures: Alternative theoretical perspectives. In P. W. Beamish & J. P. Killing (Eds.), *Cooperative strategies: North American perspectives*. San Francisco, CA: New Lexington Press.
Ren, H., Gray, B., & Kim, K. (2009). Performance of international joint ventures: What factors really make a difference and how? *Journal of Management, 35*(3), 805–832.
Reuer, J. J., & Miller, K. D. (1997). Agency costs and the performance implications of international joint venture internalization. *Strategic Management Journal, 18*(6), 425–438.
Rodriguez, P., Uhlenbruck, K., & Eden, L. (2005). Government corruption and the entry strategies of multinationals. *Academy of Management Review, 30*(2), 383–396.
Roy, J.-P., & Oliver, C. (2009). International joint venture partner selection: The role of the host-country legal environment. *Journal of International Business Studies, 40*(5), 779–801.
Roy, T. (2002). Economic history and modern india: Redefining the link. *The Journal of Economic Perspectives*, *16*(3), 109–130.
Sáez, L., & Sinha, A. (2010). Political cycles, political institutions and public expenditure in India, 1980–2000. *British Journal of Political Science, 40*(1), 91–113.
Schmid, A. A. (2004). *Conflict and cooperation: Institutional and behavioral economics*. Oxford: Blackwell.
Schotter, A. (1981). *The economic theory of social institutions*. Cambridge: Cambridge University Press.
Scott, W. (2008a). Approaching adulthood: The maturing of institutional theory. *Theory and Society, 37*(5), 427–442.
Scott, W. R. (2008b). *Institutions and organizations: Ideas and interests* (3rd ed.). Thousand Oaks, CA: Sage.
Serapio, M. G., Jr., & Cascio, W. F. (1996). End-games in international alliances. *Academy of Management Executive, 10*(1), 62–73.
Smarzynsk, B. K., & Wei, S. -J. (2002). *Corruption and cross-border investment: Firm level evidence*. The Brookings Institution working paper.
Smith, A. (1904). *An inquiry into the nature and causes of the wealth of nations* (5th ed.). London: Methuen & Co.

Spencer, J., & Gomez, C. (2011). Mnes and corruption: The impact of national institutions and subsidiary strategy. *Strategic Management Journal, 32*(3), 280–300.

Steensma, H. K., Barden, J. Q., Dhanaraj, C., Lyles, M., & Tihanyi, L. (2008). The evolution and internalization of international joint ventures in a transitioning economy. *Journal of International Business Studies, 39*(3), 491–507.

Steensma, H. K., & Lyles, M. A. (2000). Explaining IJV survival in a transitional economy through social exchange and knowledge-based perspectives. *Strategic Management Journal, 21*(8), 831–851.

Stigler, G. J. (1971). The theory of economic regulation. *The Bell Journal of Economics and Management Science, 2*(1), 3–21.

Tollison, R. D. (1982). Rent seeking: A survey. *Kyklos, 35*(4), 575–602.

Tsang, E. W. K. (2000). Transaction cost and resource-based explanations of joint ventures: A comparison and synthesis. *Organization Studies, 21*(1), 215–242.

Tullock, G. (1967). The welfare costs of tariffs, monopolies, and theft. *Economic Inquiry, 5*(3), 224–232.

Uhlenbruck, K., Rodriguez, P., Doh, J., & Eden, L. (2006). The impact of corruption on entry strategy: Evidence from telecommunication projects in emerging economies. *Organization Science, 17*(3), 402–414.

Voeten, E., Strezhnev, A., & Bailey, M. (2015). United Nations General Assembly voting data: Harvard Dataverse.

Waldman, D. A., Sully de Luque, M., Washburn, N., House, R. J., Adetoun, B., Barrasa, A. et al. (2006). Cultural and leadership predictors of corporate social responsibility values of top management: A GLOBE study of 15 countries. *Journal of International Business Studies, 37*(6), 823–837.

Weitzel, U., & Berns, S. (2006). Cross-border takeovers, corruption, and related aspects of governance. *Journal of International Business Studies, 37*(6), 786–806.

White, S., & Lui, S. S.-Y. (2005). Distinguishing costs of cooperation and control in alliances. *Strategic Management Journal, 26*(10), 913–932.

Williamson, O. E. (1989). Transaction cost economics. In R. Schmalensee & R. Willig (Eds.), *Handbook of industrial organization*. Elsevier: Amsterdam.

Williamson, O. E. (1991). Comparative economic organization: The analysis of discrete structural alternatives. *Administrative Science Quarterly, 36*(2), 269–296.

Williamson, O. E. (1998). The institutions of governance. *The American Economic Review, 88*(2), 75–79.

Williamson, O. E. (2010). Transaction cost economics: The natural progression. *Journal of Retailing, 86*(3), 215–226.

Xu, D., & Shenkar, O. (2002). Institutional distance and the multinational enterprise. *Academy of Management Review, 27*(4), 608–618.

Yan, A., & Gray, B. (1994). Bargaining power, management control, and performance in United States-China joint ventures: A comparative case study. *Academy of Management Journal, 37*(6), 1478–1517.

Yan, A., & Zeng, M. (1999). International joint venture instability: A critique of previous research, a reconceptualization, and directions for future research. *Journal of International Business Studies, 30*(2), 395–414.

Yiu, D., & Makino, S. (2002). The choice between joint venture and wholly owned subsidiary: An institutional perspective. *Organization Science, 13*(6), 667–683.

6

Do Spin-Offs Really Create Value? Evidence from India

Venkatesh Kambla

Introduction

There is a common perspective in the academic and popular literature that spin-offs tend to create value for shareholders (e.g., Cusatis, Miles, & Woolridge, 1993; Desai & Jain, 1999; Sin & Ariff, 2006; Sudarsanam & Qian, 2007; Veld & Veld-Merkoulova, 2009; Khedekar, 2013). This view is based on evidence from a number of studies using data from the USA and indicating that, on average, the announcement of a spin-off is associated with positive abnormal stock returns. Moreover, based on evidence from studies done on US firms (e.g., Cusatis et al., 1993; Desai & Jain, 1999; McConnell, Ozbilgin, & Wahal, 2001) shares of firms completing spin-offs appear to exhibit excess returns over periods of up to three years following the restructure. However, studies using

V. Kambla (✉)
Indian Institute of Management Bangalore, Bangalore, India
e-mail: vrkambla@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_6

European data have not indicated the presence of significant abnormal stock returns following spin-offs.

During the past 13 years, spin-offs have become more popular in India. In recent times, there has been considerable "buzz" in the popular press regarding spin-offs (e.g., Mampatta, 2014; Desai, 2015). The large number of Indian spin-offs completed in recent years provides us with an opportunity to examine whether the conclusion that spin-offs tend to create value applies primarily to US firms, or whether this relationship is more broadly applicable, including to emerging markets such as India.

In the academic literature, a spin-off has been defined as "when the firm distributes all of the common stock it owns in a controlled subsidiary to its existing shareholders, thereby creating a separate, publicly-traded company" (Rosenfeld, 1984: 1437). In the management literature, spin-offs are generally seen as the formation of new firms, wherein the newly formed firm is totally separated from the parent organization, in terms of control, risks, benefits, and management; sometimes, new economic activity is also created around it by way of entering new markets or businesses. In other words, an existing division or business unit is separated from the parent organization; the ownership and control are placed in the hands of new owners; and the management, risk, and rewards are transferred from the erstwhile management to a new set of individuals. In a way, we can thus view the spin-off as an activity wherein a large organization is restructured and made leaner.

A number of studies of US firms find evidence of long-term superior performance for both spin-offs and their parents (e.g., Cusatis et al., 1993; Desai & Jain, 1999; Rovetta, 2006); parents and subsidiaries involved in spin-off activity tend to outperform matched firms. An interesting question that arises is whether spin-offs, in general, are really associated with positive long-term excess returns or whether the US results are due to the unique structure of its capital markets and related institutions, which differ from other first world markets, as well as emerging markets such as India. These differences in law, and its enforcement, make it very interesting to study the long-term performance of non-US companies involved in spin-off activity, especially in light of the different results between the European and US contexts.

In this paper we study Indian spin-offs. Spin-offs have only been in regular use in India following the liberalization of the Indian economy in 1991. Post-liberalization, we witnessed a spurt in private-sector economic activity across the economy, largely due to the fall of the "licence raj".[1] Most of the economy was de-regulated, barring a few sensitive sectors, such as defense and a few other industries that were of national strategic importance. These included arms and ammunition; atomic energy; coal; mineral oil; mining of iron ore, manganese ore, gold, silver, copper, lead, zinc, and atomic minerals; and railways. At present only a few of these categories remain reserved for the public sector: atomic energy and mining of atomic minerals and mineral sand, and railways. Post-liberalization, individuals and business groups/houses—both large and small—began to engage in new businesses and industries. Simultaneously, a large number of multinational enterprises entered the Indian market, seeking to exploit opportunities to tap into a potentially huge market of nearly a billion people.

Rapid changes took place in the country's economic structure, and local players were forced to adapt to the increased competition, with both local and foreign players jostling for a share in the pie of the great Indian market. The competition and influx of new players, combined with hitherto-unopened sectors of the economy, created considerable uncertainty for businesses, who found it challenging to adapt to India's changing economic and business landscape. These external forces forced firms to rethink on their strategies for surviving and flourishing, and for maintaining their positions in their respective business. One strategy adopted by some players, in evolving a structure for their businesses, was the divestment of subsidiaries and divisions by way of spinning them off into standalone firms, or even selling certain businesses to consolidate their own positions. In the period from 2000 to 2005, 40 spin-offs took

[1] The "license raj" is a term used to describe the regulation of the private sector in India between 1947 and the early 1990s. In India, at that time, one needed the approval of numerous agencies in order to legally set up a business. Manufacturing, in particular, was heavily regulated. The licence raj was the result of a mixed economy that used a government planning commission established after India's independence. It was largely successful in the 1950s and after, but eventually led to low rates of growth and investment. India began to liberalize its economy in the 1980s, ending the licence raj (Farlex Financial Dictionary, 2012).

place. From 2006, the volume of spin-offs increased rapidly; the period from January 2006 to March 2012 witnessed no fewer than 95 spin-offs.

In this study, we have examined all of the spin-offs that took place between January 2000 and March 2012 and that were undertaken by firms listed on the Indian stock market and the resulting spun-off firm was also listed on the Indian stock market. We employed the BHAR (buy and hold abnormal return) measure to calculate the abnormal returns due to spin-off activity. The results in this chapter support the view that, on average, spin-offs create value, as they are associated with positive abnormal returns over the long term. This is in line with US studies.

The remainder of this chapter is organized as follows. In the following section, we discuss factors that explain the wealth effect from spin-offs. Data description and methodology are included in the next section, which is followed by the empirical results. The chapter is concluded with a summary of the results.

Factors that Explain the Wealth Effects from Spin-Offs

Firms that are spun-off enjoy greater discretion, when compared to internal business units, as they cease to be bound by the corporate structure of the parent firm (Hambrick & Strucker, 1999). Due to the spin-off process, the firm becomes free to adopt a financial structure viewed as best suited for its business, and has the opportunity to raise capital by way of an equity or debt issue, or to retire debt. This freedom, of course, comes along with a risk that it could face financial and organizational difficulties, as the parent company is no longer able to support it during times of crisis.

Firms engaged in the spin-off process tend to believe that it will improve the performance of the parent's stock, as investors should be able to perceive value more clearly post-separation (Krishnaswami & Subramaniam, 1999). This is due to the reduction in information asymmetry in the market about the firm's various divisions, with respect to issues of efficiency and profitability. In particular, spin-offs that occur as a result of focus-increasing strategy by the parent have been observed to improve the parent's stock market performance (Desai & Jain, 1999). Diversified firms may try to improve their investment efficiency by spinning off specific divisions; Ahn and Denis (2004) indicated that, post spin-off, there tends to be a significant change in investment policy, and investment inefficiencies are reduced. In a meta-analysis of empirical evidence on value creation through spin-offs, Veld and Veld-Merkoulova (2009) observed that spin-offs involving assets outside the parent firm's core business are generally viewed as value-increasing by the market, but the same does not apply to the spin-off of core assets.

Highly diversified conglomerates may be hampered in realizing the full benefits of diversification, due to the overrun of diversification costs, relative to benefits (e.g., Prahalad & Bettis, 1986). In such cases, firms may benefit from spinning off particular divisions, especially those operating in technology-intensive sectors or those that require swift decision-making capabilities to make them more flexible and competitive in the market (Ito, 1995). (Ahn and Walker (2007) noted that diversified firms with a strong corporate governance structure are more likely to use spin-offs when the costs of diversification exceed the benefits.) When the strategic path of a division or subsidiary becomes too divergent from that of the parent, a spin-off may be a useful result (Chemmanur & Yan, 2004). This process also gives spin-offs certain advantages over new entrants, including operational and innovative competencies developed through prior experience when attached to the parent firm, and managerial experience gained prior to being spun-off (Tubke, 2004).

Excessive layers of corporate governance can result in disconnects between the goals of the management of the subdivision or business unit and those of the shareholders (Green, 1988). In addition, lack of transparency can lead to a misalignment between incentive structures and shareholders' goals. When a division is spun-off, its management has the opportunity to become closer to the owners, due to the removal of corporate layers, allowing the goals of the two groups to become more synchronized and the incentive structure to be more aligned with the operational goals of the owners (Krishnaswami & Subramaniam, 1999). Veld and Veld-Merkoulova (2004) reported that it is likely that, after spin-off, information asymmetry is reduced, which could lead to a decrease in the undervaluation of the share value of the parent company.

Hite and Owers (1983) found that spin-offs that constituted a substantial portion of the parent firm tend to be more successful, in terms of announcement date returns. Spin-offs having larger size are generally more stable in their market position, which, in turn, increases the market expectations of a larger benefit from restructuring (Tubke, 2004).

As pointed out by Ito and Rose (1994) and Rose and Ito (2005), Japanese firms have a very different approach toward spin-offs, not seeing spin-offs as an approach to parceling off a problem division (unlike the typical US situation). Rather, Japanese firms use spin-offs as a method of diversification and value creation, to enhance the survival of the business group as a whole. Unlike the typical approach in the USA, Japanese parent firms withhold shares in the spin-off, rather than transferring all the stock to shareholders. This enables the parent to retain a tie, like an umbilical cord, with the spun-off subsidiary. Ito (1995) argued that Japanese firms use the spin-off as an organizational arrangement that is suitable to survival, and offers an alternative way of diversification.

We see a similar phenomenon in India, whose business environment, somewhat similar to Japan's, is dominated by business groups. Also most firms are family-owned, and the firms seem to be reluctant to fully let go of their hold on the spun-off subsidiary and, as such, the parent firms tend to retain their shares in the spun-off subsidiary. Therefore, it is of interest to understand more about the implications of executing the spin-off strategy in India, as related to the parent, the subsidiary, and the business group as a whole. *Prima facie*, it seems that, unlike in the USA, spin-offs may not be used as a mechanism to offload loss-making divisions/arms/subsidiaries, but more as either a reorganization of assets (e.g., when there is a split in the family) or to realize the true value of the organization as a whole (value discovery by way of listing the subsidiaries on the stock market). Are Indian firms actually able to extract value by way of spin-offs and thereby create wealth for their shareholders, by way of abnormal returns?

Data Description and Methodology

Data Description

We analyze the population of Indian spin-offs listed on the Indian stock markets. The data cover the period from January 2000 to March 2012, with announcement dates obtained from the Capital Line database. Table 6.1 reports the annual distribution of the announcements to spin-off a part of the company.

The original population consisted of 173 Indian spin-offs announcements. A number of spin-off announcements had to be eliminated from the study: 17 because the parent firms reversed the decision to spin-off a part of the firm, 13 because as the parent firms were traded quite infrequently after the spin-off, and eight because the parent firms delisted within a year of the spin-off. Thus, we were left with a sample of 135 firms that had completed the spin-off process.

Methodology

There is a wealth of literature on the calculation of long-term abnormal returns. In this literature, a number of methods are proposed, most of

Table 6.1 Observations by announcement year

Year	Number of spin-offs	Number of parent firms
2000	5	5
2001	10	9
2002	4	4
2003	6	6
2004	7	6
2005	8	8
2006	17	15
2007	16	12
2008	13	12
2009	10	9
2010	24	22
2011	13	11
2012	2	2
Total	**135**	**121**

which suffer from limitations that are statistical in nature (Fama, 1998; Lyon, Barber, & Tsai, 1999; Brav, Geczy, & Gompers, 2000). We employ one of the most commonly accepted methodologies, the matching firm approach of Barber and Lyon (1997). In this approach, we identify a matching firm, based on the size of the company and its market-to-book ratio. First, we divide all of the listed companies in India into deciles, based on size, operationalized as the market value of equity. In the decile that includes the sample firm, we identify five companies that are closest to the focal firm, in terms of the market-to-book ratio. The closest matching firm is identified as the first matching firm, the second closest matching firm is identified as the second matching firm, and so on, to the fifth matching firm. The equity share return for the sample firm is then compared to the return on the matching firm. If the first matching firm disappears from consideration for some reason (e.g., dissolution), we use the second matching firm from that point in the analysis; if the second firm also disappears, we continue with the third matching firm, and so on. The application of this method only allows for the comparison of means, via the use of independent sample *t*-tests for the means.

Results

Table 6.2 shows the mean annualized returns both of parent companies and the spin-offs in the period after the spin-off. We are investigating if there is any statistical difference between the mean annualized returns from spin-off firms and those of a matching firm based on similarity in the two firms' market-to-book ratios.

Loughran and Ritter (2000) stated that equal-weighted returns are relevant, from the point of view of an investor who wants to predict the abnormal returns associated with a random event. Fama (1998) argued that value-weighted returns should be studied, because they more accurately capture the total wealth effects that are experienced by investors. We choose to undertake analysis of equal-weighted returns, on the basis that we want to test whether a random spin-off is likely to be associated with superior long-term performance. If we were to use value-weighted returns, then the results due to a firm whose relative value is very large would

Table 6.2 Long term returns in excess of matching firm return

	Mean (in %)	*t*-statistic
Panel A: All parent firms		
T_0 to T_0+6	1.3	0.86
T_0 to T_0+12	6.4	0.98
T_0 to T_0+24	17.2	2.15**
T_0 to T_0+36	18.7	2.27**
Panel B: All subsidiaries		
T_0 to T_0+6	0.7	1.12
T_0 to T_0+12	3.7	1.79*
T_0 to T_0+24	8.3	2.17**
T_0 to T_0+36	11.3	2.32**

* p<0.10, ** p<0.05

have a bearing on the outcome of the results. In Table 6.2, the abnormal returns are estimated as the difference between the company returns and the returns on a matching firm.

In Panel A of Table 6.2, the results for the parent companies are presented. The mean annualized returns are significantly (p<0.05) positive only for the periods of 24 and 36 months after the spin-off. In Panel B, we present the results for spin-offs. The mean annualized returns are positive for the periods of 12 (p<0.10), 24 (p<0.05), and 36 (p<0.05) months post-spin-off. Thus, we identify positive abnormal returns for the periods of 24 and 36 months after the spin-off activity for both parent and spin-offs, along with 12 months for the spun-off firms. This could imply that firms that might have diversified excessively, yielding negative synergies due to misalignment of resources and the dilution of core competencies due to size. Spinning off a subsidiary might help in unlocking value by creating looser connections with assets or units that are not part of the core business of the firm.

Summary and Conclusions

In their study of US spin-off firms, Krishnaswami and Subramaniam (1999) quoted prior research and argued that the primary reasons for spin-off, as cited in the literature, are improvement in focus and the elimination of negative synergies. They also noted that practitioners indicate that the main motivation for spin-offs is information-related. However, they argued that, if the reasons for spin-off activities were solely improvement in focus and the removal of negative synergies, then any mode of divestiture could be undertaken. The authors suggested that firms might undertake spin-offs when they expect the possibility of value being unlocked by reducing information asymmetry. Khedekar (2013) noted that there is evidence that conglomerates in India have undertaken restructuring when they perceive they have become bloated, taking actions such as spinning off or demerging loss-making divisions to bolster the parent's stock that has been weighed down by the diversion of resources.

Daley, Mehrotra, and Sivakumar (1997) argued that cross-industry spin-offs create more value than own-industry spin-offs. Managerial skills may be particularly well-suited to the firm's core business, but not non-core businesses. In this situation, freeing managers and owners from these non-core activities may improve their efficiency and, thereby, the performance of the parent firm.

At any given point in time, managers have an in-built limit to the extent of diversity they can manage efficiently, with respect to mind-set, concept of a particular business, and the administrative techniques that have yielded success in the past. It can be difficult for the top management to adapt and manage host of challenges across various industries. In this regard, it may make more sense to spin-off a business unit that is distant from the core operations of the business (Prahalad & Bettis, 1986).

The creation of spin-offs can be consistent with the objective of the firm, as it is a real challenge for any organization to sustain growth and remain at the top of the game for a long time. When the firm finds it difficult to maintain the leadership position in its industry, it becomes necessary to pursue an alternative approach that makes it possible for the firm to realign itself to achieve its objectives. Also, if the top management of the firm feels that a division/subsidiary will be more suited as a separate entity for various reasons (such as new market exploration, or new product development, or exploration of a new business), yet wants to retain some relationship so the primary owners are benefited in terms of wealth maximization, a spin-off represents a valid alternative.

This chapter has addressed the wealth effects in Indian capital markets, for spin-offs, studying medium and long-term performance for a sample of 135 Indian spin-offs announced from January 2000 to March 2012.

We find evidence of a positive long-term wealth effect associated with the use of the spin-off strategy. This is in line with prior results from the USA and Japan, but unlike results from studies undertaken using European data. The returns for both the parents and the spun-off subsidiaries, when compared to the return for a matching firm, are both economically and statistically significant at 24 and 36 months post-event. It is surprising to see this result, when the corporate governance system of India is different from that of the USA. Differences in corporate governance between the countries can be measured by means of the index of La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998), which is one of the measures that indicates that shareholders of companies in India are less protected than shareholders in the USA. However, the results do not look all that surprising when we compare the Indian firms to their Japanese counterparts, as the promoters of Indian firms also hold stakes in the firms that they spin-off from the parent firm. Our findings suggest that market reaction to a spin-off announcement transcends differences in corporate governance systems. These results pose a few questions for further research, especially with respect to the question of why firms use the spin-off strategy. What is the motivation for the Indian firms to undertake spin-offs? Is it discarding of problematic divisions, as observed in US firms, or is it a case of group survival strategy, like that noted in studies of Japanese firms by Ito and Rose (1994) and Rose and Ito (2005).

References

Ahn, S., & Denis, D. P. (2004). Internal capital markets and investment policy: Evidence from corporate spin-offs. *Journal of Financial Economics, 71*(3), 489–516.

Ahn, S., & Walker, M. D. (2007). Corporate governance and the spin-off decision. *Journal of Corporate Finance, 13*(1), 76–93.

Barber, B. M., & Lyon, J. D. (1997). Detecting long-run abnormal stock returns: The empirical power and specification of test statistics. *Journal of Financial Economics, 43*(3), 341–372.

Brav, A., Geczy, C., & Gompers, P. A. (2000). Is the abnormal return following equity issuances anomalous? *Journal of Financial Economics, 56*(2), 209–249.

Chemmanur, T. J., & Yan, A. (2004). A theory of corporate spin-offs. *Journal of Financial Economics, 72*(2), 259–290.

Cusatis, P. J., Miles, J. A., & Woolridge, J. R. (1993). Restructuring through spinoffs: The stock market evidence. *Journal of Financial Economics, 33*(3), 293–311.

Daley, L., Mehrotra, V., & Sivakumar, R. (1997). Corporate focus and value creation: Evidence from spinoffs. *Journal of Financial Economics, 45*(2), 257–281.

Desai, H., & Jain, P. C. (1999). Firm performance and focus: Long-run stock market performance following spin-offs. *Journal of Financial Economics, 54*(1), 75–101.

Desai, N. (2015). *M&A landscape in India: What to expect in 2015?* (http://www.mondaq.com/india/x/367482/Shareholders/MA+LANDSCAPE+IN+INDIA+WHAT+TO+EXPECT+IN+2015)

Fama, E. F. (1998). Market efficiency, long term returns, and behavioural finance. *Journal of Financial Economics, 49*(3), 283–306.

Farlex Financial Dictionary. S.V. (2012). *"License raj."* Retrieved April 12, 2016, from http://financial-dictionary.thefreedictionary.com/License+raj

Green, S. (1988). The incentive effects of ownership and control in management buy-outs. *Long Range Planning, 21*(1), 26–34.

Hambrick, D. C., & Strucker, K. (1999). Breaking away: Executive leadership of corporate spin-offs. In *The change leader's handbook*. San Francisco, CA: Jossey-Bass.

Hite, G. L., & Owers, J. E. (1983). Security price reactions around corporate spinoff announcements. *Journal of Financial Economics, 12*(4), 409–436.

Ito, K. (1995). Japanese spinoffs: Unexplored survival strategies. *Strategic Management Journal, 16*(6), 431–466.

Ito, K., & Rose, E. L. (1994). The genealogical structure of Japanese firms: Parent-subsidiary relationships. *Strategic Management Journal, 15*(S2), 35–51.

Khedekar, S. (2013). Becoming lean and mean. *Capital Market, XXVII*/26 February 18–March 03, 81–84.

Krishnaswami, S., & Subramaniam, V. (1999). Information asymmetry, valuation, and the corporate spin-off decision. *Journal of Financial Economics, 53*(1), 73–112.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., & Vishny, R. (1998). Law and finance. *Journal of Political Economy, 106*, 1113–1155.

Loughran, T., & Ritter, J. R. (2000). Uniformly least powerful tests of market efficiency. *Journal of Financial Economics, 55*(3), 361–389.

Lyon, J. D., Barber, B. M., & Tsai, C. L. (1999). Improved methods for tests of long run abnormal stock returns. *Journal of Finance, 54*(1), 165–201.

Mampatta, S. P. (2014, July 7). Spin-off season on Dalal Street. *Business Standard*. (http://www.business-standard.com/article/markets/spin-off-season-on-dalal-street-114070700920_1.html)

McConnell, J. J., Ozbilgin, M., & Wahal, S. (2001). Spin-offs, ex ante. *Journal of Business, 74*(2), 245–280.

Prahalad, C. K., & Bettis, R. A. (1986). The dominant logic: A new linkage between diversity and performance. *Strategic Management Journal, 7*(6), 485–501.

Rose, E. L., & Ito, K. (2005). Widening the family circle: Spin-offs in the Japanese service sector. *Long Range Planning, 38*(1), 9–26.

Rosenfeld, J. D. (1984). Additional evidence on the relation between divestiture announcements and shareholder wealth. *Journal of Finance, XXXIX*(5), 1437–1448.

Rovetta, B. (2006). Investment policies and excess returns in corporate spinoffs: Evidence from the U.S. markets. *Financial Markets and Portfolio Management, 20*(3), 287–307.

Sin, Y. C., & Ariff, M. (2006). *Corporate spinoffs and the determinants of stock price changes in Malaysia*. Working paper, Monash University (http://www.alanyoonassociates.com/news/corp_spinoffs.pdf)

Sudarsanam, P., & Qian, B. (2007). *Catering theory of corporate spinoffs: Empirical evidence from Europe*. Available at SSRN: http://ssrn.com/abstract=891101

Tubke, A. (2004). Success factors of corporate spin-offs. *International Studies in Entrepreneurship*. Norwell, MA: Kluwer Academic Publishers.

Veld, C., & Veld-Merkoulova, Y. V. (2004). Do spin-offs really create value? The European case. *Journal of Banking and Finance, 28*(5), 1111–1135.

Veld, C., & Veld-Merkoulova, Y. V. (2009). Value creation through spin-offs: A review of the empirical evidence. *International Journal of Management Reviews, 11*(4), 407–420.

7

The Influence of Liabilities of Origin on EMNE Cross-Border Acquisition Completion

Shobhana Madhavan and Deepak Gupta

Introduction

A recent, and an increasingly salient, trend in the global business landscape has been the rapid rise in outward foreign direct investment (FDI) by multinationals from emerging economies such as India and China. The percentage of total world outward FDI from emerging economies grew from just 5 % in 1990 to a substantive 34 % in 2014 (UNCTAD, 2015). Emerging-market multinational enterprises (EMNEs) have been following trajectories different from those predicted by dominant theoretical perspectives on internationalization. One of these differences is a

Shobhana Madhavan (✉)
Deakin University Burwood VIC Australia
Amrita School of Business Coimbatore India
e-mail: m_shobhana@cb.amrita.edu

Deepak Gupta
Amrita School of Business Coimbatore India
e-mail: dgshobs@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_7

preference for high-commitment entry modes, such as acquisitions in heterogeneous geographies; this is contrary to the path of incremental internationalization predicted by the Uppsala model (Johanson & Vahlne, 1977). In fact, the cross-border acquisition (CBA) has been recognized as one of the key entry modes for emerging-economy firms, with the value of these acquisitions growing from US$9.5 billion in 1990 to US$152 billion in 2014, accounting for a record-high share of 38 % of the total M&A activity across the globe (UNCTAD, 2015). Scholars have theorized that EMNEs undertake acquisitions in order to obtain strategic assets, such as cutting-edge technology, or global brands, in order to compensate for lack of these conventional firm-specific advantages (Luo & Tung, 2007; Mathews, 2006; Contractor, 2013). Acquisitions may also be used as a means to overcome liabilities of origin, such as underdeveloped institutions in the home country, inadequate managerial capabilities, and the lack of global reputation (Child & Rodrigues, 2005; Bonaglia, Goldstein, & Mathews, 2007; Madhok & Keyhani, 2012). However, a question that has yet to be asked, and the focus of this study, is that, while CBAs may help EMNEs traverse the reputation barrier and gain global capabilities, to what extent do these liabilities of origin influence acquisition completion?

This question becomes interesting in light of reports that some EMNE acquisitions are not delivering the anticipated synergies (Karnani, 2012). Further, the abandonment rate of acquisitions is fairly high among EMNEs, with one estimate at 53 % for Chinese firms and 33 % for Indian firms, for CBAs made between 2000 and 2008 (Sun, Peng, Ren, & Yan, 2012). The reasons behind these low deal completion rates are not yet clear. Most studies on deal completion have focused on the influence of factors such as target firm performance, quality of the bid, ownership, deal structure, bid premiums, and size, and have generally involved MNEs from advanced economies (e.g., Holl & Kyriazis, 1996; King, Dalton, Daily, & Covin, 2004). In fact, there has been surprisingly little research on the factors influencing EMNE deal completion. In one of the few studies on this topic, Zhang, Zhou, and Ebbers (2011) investigated the influence of institutional quality, type of target industry, and firm type on deal completion among Chinese firms, and found that deals involving targets in sensitive industries or located in countries with lower institutional quality had a lower likelihood of deal completion. In addition, if the acquiring firm was a Chinese state-owned enterprise, then the likelihood of success was also lower than for private companies.

Understanding the factors that influence deal completion is important, as the failure to complete acquisitions is associated with substantial costs, both financial and in terms of managerial opportunity (Dikova, Sahib, & van Witteloostuijn, 2010). Furthermore, failed attempts can also lead to long-term psychological costs, as managers may feel discouraged from attempting subsequent acquisitions (Thomas, Eden, Hitt, & Miller, 2007). Semadeni, Fraser & Lee, (2008) found that CEOs who fail to close M&A deals may face stigmas in their careers.

This study becomes particularly important, given both the increasing participation of EMNEs in cross-border M&A activity and the high failure rate of acquisitions, even among multinationals from advanced economies (AMNEs). The failure rate of AMNEs has been reported as anywhere in the range of 40–75 % (Cartwright & Schoenberg, 2006; Marks & Mirvis, 2011; Sirower, 1997). Given that AMNEs have been shown to have such a low success rate in acquisitions, even without facing origin-linked liabilities, our contention is that EMNEs will face even greater challenges in their CBAs. In other words, the success of the deliberate strategic choice of CBAs as a means of overcoming EMNEs' liabilities of origin may itself be impacted by these liabilities.

The Liabilities of Origin

The term "liabilities of origin" was first used by Bartlett and Ghoshal (2000), to describe the cognitive liabilities of over- and under-confidence faced by EMNE managers in their efforts to go global. Ramachandran and Pant (2010) further investigated the concept of liabilities of origin (LOR), and identified three factors leading to LOR: underdeveloped institutions, the absence of organizational global experience, and the negative stereotypes that prevail for products and institutions from emerging markets. While the influence of origin-linked factors, such as underdeveloped institutions and a lack of firm-specific advantages, on the internationalization of firms from developing countries was investigated in the early literature on EMNEs (e.g., Lall, 1982; Lecraw, 1977), these disadvantages were not looked at in the context of acquisitions. This is logical, given that cross-border M&A activity by EMNEs was very limited prior to 2000. The empirical research on the liabilities of origin has so far been limited, and has focused mainly on the issue of legitimization strategies used by EMNEs in response to the LOR that they face when internationalizing (Pant & Ramachandran, 2012; Bangara, Freeman, & Schroder, 2012; Klossek, Linke, & Nippa, 2012). Little is known about the impact of LOR on EMNE acquisition completion. It is our premise that the CBA experience of EMNEs is likely to be different from that of their advanced-economy counterparts, largely because of their LOR. In addition to the disadvantages caused by underdeveloped institutions and limited global experience, EMNEs' lack of legitimacy and status may also impact acquisition completion. The role of status becomes particularly interesting when EMNEs take over firms in developed countries, as it helps us to investigate a hitherto-unexplored paradox, namely, what happens when the traditional hierarchical positions of acquirer and target firms are reversed? In other words, what happens when the acquiring firm has a lower status than the target firm, because of its origin in an emerging economy? In the M&A literature, the lower status or relative standing of target firm managers has been shown to create conflicts and cause executive departures, adversely impacting performance (Hambrick & Cannella, 1993). Relative status could thus play an important role in influencing the success of an acquisition.

The rest of the chapter is structured as follows. We draw upon theoretical insights from the literature on institutions, organizational learning, and organizational status to build our conceptual model. We then develop hypothesis relating to the influence of the different dimensions of LOR on the CBA process. This is followed by a description of the methodology. We detail the results of this analysis and its implications, and conclude with a discussion on the limitations of our study and directions for future research.

Theory and Hypotheses

The Advantages and Disadvantages of MNEs

Dominant theoretical perspectives on international business, such as Dunning's Eclectic Paradigm, or OLI framework (e.g., Dunning, 1988), have focused on MNEs' ownership-specific, location-specific, and internalization-specific advantages that pertain to internationalization. Rugman and Verbeke (2003) posited that EMNEs internationalize to expand on their firm-specific advantages (FSAs), which they define as unique capabilities proprietary to an organization, such as technology, managerial, and marketing skills. Scholars have proposed that, while EMNEs may not possess conventional FSAs, they possess other advantages, such as resilience, frugality, embeddedness within family businesses and conglomerates, a large and technically competent workforce, and tolerance for ambiguity (e.g., Guillen & Garcia-Canal, 2009; Rugman & Li, 2007; Contractor, 2013).

There have been attempts to extend or adapt existing internationalization theories to improve their relevance to EMNEs. For example, in the linkage, leverage, and learning model, Mathews (2006) presented an adaptation of Dunning's OLI framework, suggesting that MNEs from Asia are able to expand internationally by accessing resources through linkages to external firms, leveraging these resources, and subsequently engaging in a process of learning from repeated application of linkage and leverage. While the importance of EMNE-specific *advantages* cannot be denied, it is our contention that, in spite of these advantages, EMNE liabilities of origin could still lead to constraints in their internationalization. These liabilities of origin are faced by EMNEs, in addition to the liability of foreignness that is faced by all foreign firms. The liability of foreignness is defined as the additional costs an MNE operating in a market overseas incurs that a local firm would not (Zaheer, 1995), and has been widely investigated in the IB literature; see Denk, Kaufmann, and Roesch (2012) for a review.

Liabilities of Origin Versus the Liability of Foreignness

Theoretical perspectives on the disadvantages faced by MNEs in their host countries can be traced back to Stephen Hymer's classical study, which stated that firms faced additional costs when doing business abroad (Hymer, 1976), including relative production costs; the costs of managing operations at a distance; and the costs of managing negotiations, monitoring, and dispute resolution with different stakeholders. Additional costs include discrimination hazards faced if the host country governments favor local firms, and unfamiliarity hazards that can be attributed to lack of knowledge of the local market (Eden & Miller, 2001). Zaheer (1995), building on this concept, included the cost of multinationality—the cost of managing operations at a distance—as a liability of foreignness (LOF), and excluded the relative production costs in the definition of LOF. While EMNEs, like all other MNEs, face LOF in their foreign operations, they may also face LOR.

The concepts of LOR and LOF are distinct. First, LOR pertains to disadvantages borne by MNEs in host countries because of "where they are from", that is, their specific nationality, while LOF relates to the disadvantages borne by MNEs in host countries as a result of "where they are not from" (i.e., not local) (Ramachandran & Pant, 2010: 25). The liability of foreignness is a relative term, pertaining to the additional cost incurred by a foreign firm, compared to local firms. Second, home country influence is explicitly excluded in the measurement of LOF (Mezias, 2002), while it is this very influence that gives rise to LOR, which is linked to the country of origin. In the marketing field, one of the most widely researched concepts is the country-of-origin (COO) effect, or the influence of the national origin of a product or service on the purchase decision (Peterson & Jolibert, 1995), with developing countries often found to suffer from a negative country image. The focus of the COO literature has traditionally been on consumer products and services, rather than the origin-linked disadvantages faced by firms from emerging economies. The concept of liability of origin is thus distinct from both the liability of foreignness and the country of origin.

Theoretical Underpinnings

The literature on the liabilities of origin has drawn on institutional theory (e.g., North, 1990; Scott, 1995) and organizational learning theory (e.g., Levitt & March, 1988; Fiol & Lyles, 1985), to explain the sources of these liabilities. Institutions can be defined as the "the rules of the game in a society or, more formally, as the humanly devised constraints that shape human interactions" (North, 1990: 3). Scott defined institutions in terms of regulatory, normative, and cognitive pillars that provide stability and meaning to social behavior (Scott, 1995). The regulatory pillar relates to the laws and regulations in a society, the normative pillar defines what people "should or should not do" (Eden & Miller, 2004: 201), and the cognitive pillar affects the ways in which people interpret stimuli from the environment and what people "can or cannot do" (Eden & Miller, 2004: 201). In developing countries, the regulatory pillar contributes to the LOR because rules, laws, and sanctions are often underdeveloped. The normative and cognitive pillars contribute to the LOR, as the EMNE's home country's normative and cognitive pillars may be perceived as conflicting with the corresponding pillars in the host country, especially when the institutional distance between the two countries is large (Xu & Shenkar, 2002; Liou, Rose, & Ellstrand, 2012). These perceptions may lead to negative stereotypes of EMNEs, making it difficult for them to gain organizational legitimacy.

Organizational legitimacy has been defined as the "congruence between the social values associated with or implied by organizational activities and the norms of acceptable behavior in the larger social system" (Dowling & Pfeffer, 1975: 122). In order to gain organizational legitimacy, in addition to following rules and regulations in the host country, firms may need to adapt the cognitive structures, normative values, and ways of doing things that are typical in the host country. Even if EMNEs are able to overcome resource constraints and institutional voids, gaining legitimacy has been shown to be extremely challenging (Bangara et al., 2012; Pant & Ramachandran, 2012). Legitimacy can enhance credibility and the firm's chance of survival, because local players are more likely to support and supply resources to organizations that appear to be desirable and trustworthy (Suchman, 1995; Kostova & Zaheer, 1999). EMNEs are able to build legitimacy and overcome LOR through strategies such as alliances with international firms from advanced economies, acquiring global brands, locating their headquarters in western nations, and acquiring international certifications (Bonaglia et al., 2007; Pant & Ramachandran, 2012).

In addition to legitimacy, status may play an important role in EMNE acquisitions. Status has been defined as the "prestige accorded actors because of their social positions" (Jensen & Roy, 2008: 495) or the "socially constructed, inter-subjectively agreed-upon and accepted ordering or ranking of individuals, groups, organizations, or activities in a social system" (Washington & Zajac, 2005: 284). Even though status and legitimacy are complementary, they are distinct (Bitektine, 2011). While legitimacy denotes a level of acceptability, status (while implying acceptability) is concerned with prestige. Empirical research has shown that associating with a lower status firm may lead to a loss of status, while associating with a higher status firm may improve status (Podolny & Phillips, 1996; Jensen & Roy, 2008). Transaction costs have been found to be lower for high-status actors than for low-status actors (Podolny & Phillips, 1996). An important ramification of status for the current study is that low status of organizations has been associated with discrimination in the selection of business partners or participation in events (Washington & Zajac, 2005; Jensen, 2008). This has been corroborated by studies in the international human resource management literature, which found that job candidates tend to show a preference for advanced-economy MNEs to EMNEs as future employers (Alkire, 2014; Thite, 2012; Tung, 2007). The extant literature thus suggests that EMNEs are likely to face problems in getting a higher status target firm (e.g., an AMNE) to accept them as an acquirer.

The Role of Organizational Learning

In addition to institutional voids, lack of legitimacy, and low status, another liability of origin is the EMNE's lack of global experience. Understanding the processes of organizational learning (Levitt & March, 1988; Fiol & Lyles, 1985) becomes critical to understand this liability. Organizational learning has been defined as the development of knowledge based on past firm behavior and applying these insights and associations to future actions (Fiol & Lyles, 1985). According to this theory, learning is a dynamic process, as firms are constantly learning, building, and adapting routines and processes to apply in future experiences (Levitt & March, 1988). Acquisitions can provide firms with quick access to knowledge and resources, and help them to learn new routines and repertoires (Morosini, et al., 1998; Barkema & Schijven, 2008). CBAs have been recognized as important tools of learning, and provide access to potentially valuable embedded knowledge and capabilities (Vermeulen & Barkema, 2001). However, learning from acquisitions is not straightforward. Acquisitions are often made for different reasons and may be irregular; each acquisition is unique. Relatively inexperienced acquirers may generalize acquisition experience inappropriately to dissimilar acquisitions (Haleblian & Finkelstein, 1999; Hayward, 2002). It has been shown that a certain level of context specificity is necessary to foster learning, and firms do not learn from every acquisition (Vermeulen & Barkema, 2001). In the context of EMNE acquisitions, this theoretical insight will be used to investigate whether experience in the same country (a similar context) plays a more important role than breadth, or a range of geographical experience. These theoretical inputs help to design the conceptual model described in the next section.

Conceptual Model

The extant literature has described different types of liabilities of origin Bartlett and Ghoshal (2000) focused on psychological liabilities faced by EMNE managers, namely, a liability of under-confidence in their global capabilities and the converse liability of over-confidence caused by lack of exposure. Ramachandran and Pant (2010) classified LOR along three dimensions: (i) underdeveloped institutional intermediaries in the home country, (ii) discrimination in the host country, and (iii) organizational weaknesses. Developing on this work, Madhok and Keyhani (2012) classified what they termed “liability of emergingness” into two types, one caused by factors external to the firm ("institutional deficit"), and the other caused by factors internal to the firm ("managerial and capability deficit"), leading to a "legitimacy and credibility" deficit. The classifications of Ramachandran and Pant (2010) and Madhok and Keyhani (2012) are essentially similar, as they include liabilities relating to organizational weaknesses, institutional voids, and credibility. While these scholars described different aspects of LOR, they did not undertake empirical testing of the influence of LOR.

Careful analysis of the extant literature reveals that EMNE liabilities seem to be caused both by an *actual* lack of capabilities and by a *perception* of a lack of capabilities. In our model, we term the actual lack of liability as "capability liability". This capability liability can be attributed to the EMNE's lack of global experience, which may result in inadequate routines and processes for handling the complex process of CBAs. Further, this lack of experience may result in a low level of confidence among EMNE managers during negotiations and post-acquisition integration. The firm's capability can also be limited by institutional voids, such as inadequate financial and investment freedom, and related bureaucratic hurdles. We term the second category of liabilities, or the perception of lack of capability, as "credibility liability". The credibility liability can be attributed to both a lack of legitimacy and a low status. Even if an EMNE is familiar, and its structure and processes are acceptable and hence legitimate, it may still be considered lower in status than an MNE from advanced economy. AMNEs may enjoy a higher status in the business world than EMNEs because of superior brand image, more advanced technology, and their international strategic presence and stature (Sethi & Judge, 2009; Smith & Meiksins, 1995). Based on this categorization, we build our conceptual model as shown in Fig. 7.1.

We now explore the influence of these two categories of liabilities on acquisition completion. The steps in acquisition completion include the search for the strategic partner, negotiations, integration planning, and closing the deal (DePamphilis, 2013). After selecting a suitable target, the due diligence, or review of the target firm's records and facilities, often takes place through the negotiation phase. In addition to agreeing on the purchase price, negotiations involve deciding on the form of payment, tax and accounting considerations, and legal details. Integration planning involves deciding how operational, functional, and socio-cultural

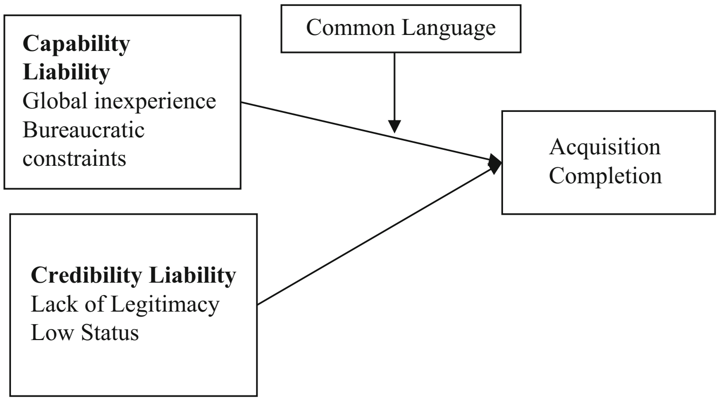


Fig. 7.1 Conceptual model for the influence of liabilities of origin on EMNE cross-border acquisition completion

integration will be structured and implemented (Shrivastava, 1986). After these stages, if both parties are satisfied, the acquisition is completed. The final stage includes obtaining approvals from regulatory authorities, shareholders and other stakeholders with whom the target firm has existing contracts (DePamphilis, 2013). Thus, acquisition completion is a very complex process, involving multiple stages and several stakeholders

Capability Liability and Acquisition Completion

First Experience in a Nation

Organizations learn from direct experience and develop processes, routines, and frameworks from the interpretation of that experience (Levitt & March, 1988). Firms have been found to benefit from previous acquisition experience in a country (e.g., Barkema, Bell, & Pennings, 1996). Cross-border investments often involve complicated negotiations that may last for several months, and even years, between multiple stakeholders. In order to be successful in these negotiations, the managers involved have to understand the rules of the "negotiating game", such as determining the key players and decision-makers (Sebenius, 2002). Another skill required during this phase is cross-cultural competence and team management (Brett, Friedman, & Behfar, 2009). EMNE managers may not be internationally savvy, and may lack the capabilities required for handling these processes. The effect of inexperience is likely to be exacerbated when the EMNE acquires a firm for the very first time in a particular nation; because of the lack of familiarity with laws, regulation, practices, and national culture, the EMNE will be something of a "stranger in a strange land". EMNE managers may not know fully what financial, legal, and other resources are required for deal completion in the new setting. On this basis, we hypothesize:

Hypothesis 1 The likelihood that the cross-border acquisition deal will be completed is lower when it represents the firm's first acquisition experience in the target nation.

The Influence of Language

The negotiation process is facilitated if the two parties share a common language. The use of interpreters and translators can hamper and lengthen the process, and lead to miscommunication (e.g., Sebenius, 2002). Language barriers can especially delay due diligence processes. A common language has been found to lower transaction costs and facilitate doing business in unfamiliar markets (e.g., Doh, Bunyaratavej, & Hahn, 2009). For example, the lack of English-speaking capability among Chinese CEOs has been found to be a major barrier to their success in the USA (Peng, 2012). Deal completion also involves extensive documentation, requiring language skills. Thus, the lack of a common language is likely to further accentuate the capability liability, while a common working language is expected to mitigate the influence of this liability. We, therefore, propose the following hypothesis:

Hypothesis 2 A common working language moderates the relationship between the first time experience in a target nation and the likelihood that the cross-border acquisition deal will be completed, such that the negative relationship becomes weaker if the partners' home nations share a common working language.

Prior Acquisition Experience

Organizational learning theory suggests that there will be transfer of prior acquisition experience to a subsequent acquisition (Barkema & Schijven, 2008). The literature indicates that it is not just the number of acquisitions that affect organizational learning positively, but also their breadth and whether the context of the previous experience is related to the current acquisition experience (Haleblian & Finkelstein, 1999). Organizations with prior acquisition experience are more likely to be able to manage the targeting process effectively, which, in turn, will facilitate acquisition completion (Larsson & Finkelstein, 1999). This suggests the following hypothesis:

Hypothesis 3 There is a positive relationship between prior successful cross-border acquisition experience and the likelihood that the cross-border acquisition deal will be completed.

Geographic Acquisition Experience

Acquisition experience has been shown to be of greater value in related contexts (Haleblian & Finkelstein, 1999). Specificity of experience helps a firm to transfer knowledge and make appropriate changes to organizational processes and routines (Barkema & Schijven, 2008). When acquisitions are heterogeneous, it is more difficult to apply learning to the new settings (Hayward, 2002). If firms have previously acquired targets in a particular country, they are more likely to be familiar with both the legal requirements and host country stakeholders; learning may not necessarily occur from experiences in dissimilar countries (Barkema et al., 1996), and firms may not be able to apply more general knowledge about new cultures in different settings (Nadolska & Barkema, 2007). On this basis, we suggest the following hypothesis:

Hypothesis 4 There is a negative relationship between the number of countries (other than the focal country) in which a firm has made acquisitions and the likelihood that the cross-border acquisition deal will be completed.

Bureaucratic Constraints

Institutions affect organizational success (Scott, 1995), and regulatory quality can influence acquisition. The rules of the cross-border M&A game, such as antitrust laws and governing regulations, are extremely complex (Dikova et al., 2010). EMNEs may find it easier to complete an acquisition in a country in which laws and regulations are transparent and consistent, and where legal enforcement of acquirer interests is assured. Location choices of acquisitions by Chinese and Indian firms have been found to be related to regulatory quality except in the mining sector (De Beule & Duanmu, 2012). The likelihood of deal completion for Chinese firms shows evidence of being positively related to the host country's institutional quality (Zhang, et al., 2011). This suggests the following hypothesis:

Hypothesis 5 There is a positive relationship between regulatory quality in the target host nation and the likelihood that the cross-border acquisition deal will be completed.

Credibility Liability and Acquisition Completion

Status Differences

Status is a multilevel concept that can operate at the level of the individual, the firm, and the nation. In M&As, status conflicts at the individual level, between managers of the target and acquirer firm, have been shown to lead to executive departures (Hambrick, 1993). At the organizational level, status has been found to influence the choice of partners, transaction costs, negotiation outcomes, and access to resources (Sauder, Lynn, & Podolny, 2012). At the national level, status can be measured on the basis of economic, political, cultural, geographical, and other factors (Shimbori, Ikeda, Ishida, & Kondô, 1963).

A negative country image contributes to the low status of developing nations. Country image has been measured along several dimensions, including standard of living, level of education, and cultural and political similarity (Parameswaran & Pisharodi, 1994; Pereira, Hsu, & Kundu, 2005). Social status is used as a criterion for selecting partners, and high-status actors have been shown to experience a drop in status if they collaborate with low-status actors (Jensen & Roy, 2008; Sauder et al., 2012; Washington & Zajac, 2005). High-status actors tend to have more favorable outcomes in negotiations (Ball & Eckel, 1996). Further, status signals matter more under conditions of uncertainty, such as cross-border ventures, increasing the reluctance of firms to enter into relationships with those who are lower in status (Podolny & Phillips, 1996). EMNEs, therefore, are less likely to be the preferred partner because of their low status, and also likely to be at a disadvantage during the negotiations process, delaying acquisition completion. Collectively, these arguments suggest the following hypothesis:

Hypothesis 6 There is a negative relationship between the status difference between the M&A firms' home nations and the likelihood that the cross-border acquisition deal will be completed.

Legitimacy of Public Sector Firms

Firms operating in the public sector are likely to be less acceptable or legitimate when they attempt to acquire foreign firms. The lack of transparency in their accounting practices, excessive bureaucracy, and possible cronyism with respect to the appointment of top officials are some of the factors that make these firms less credible in foreign countries. They are often perceived as being inefficient and vulnerable to political interference, leading to a lack of socio-political legitimacy. (Zhang et al., 2011). Further, public sector firms often operate in industries that are critical to the economy, such as oil and mining Acquisitions in the mining and petroleum sector by EMNEs have been blocked by host country governments in advanced economies, because of issues of national security (De Beule & Duanmu, 2012). Public sector firms are thus more likely to suffer from a lack of legitimacy and face hurdles in their acquisition completion, leading to the following hypothesis:

Hypothesis 7 The likelihood of cross-border deal completion is lower when the acquirer is a public sector firm.

EMNEs can undertake strategic efforts to increase their credibility in the target firm's home nation. For example, they may register their headquarters in an advanced economy, signaling that they are capable of adhering to stringent regulations (Bangara et al., 2012). They may hire the services of global branding firms, or develop strategic alliances with high-status firms before undertaking acquisitions (Bonaglia et al., 2007). Indian IT firms have been undertaking legitimacy-building measures in the USA through various strategies, including listing on US stock exchanges and appointing members of the Indian diaspora to senior management positions, to assist in the development of trust with potential clients. They have also formed associations such as National Association of Software and Service Companies, and obtained prestigious US certifications such as the Capability Maturity Model and ISO 9001 (Pant & Ramachandran, 2012). Such strategic legitimacy-building efforts are likely to make the EMNE firm more known and acceptable in target nations, leading to the following hypothesis:

Hypothesis 8 Strategic legitimacy-building efforts by an industry increase the likelihood that cross-border acquisition deals will be completed in that sector.

Methodology

Data and Sample

The current study uses a sample of CBAs made by Indian MNEs between 1999 and 2013. Developing countries in Asia have been very active in CBAs since 2000 (UNCTAD, 2014), and Indian MNEs have stood out for both the range of sectors in which they invest and their success with acquisitions in advanced economies. Indian MNEs have been acquiring companies in the primary, manufacturing, and service sectors (Kumar, 2008; Ray & Gubbi, 2009), and approximately 70 % of the acquisitions made by Indian MNEs have been in advanced economies (Pradhan, 2007). These acquisitions have been made in spite of the image of a country that is not business-friendly, as indicated by India's very low rank of 142 (among 189 countries) in the 2014 World Bank Group's "Ease of Doing Business" assessment. Thus, selecting MNEs from India for this study, with their diverse range of cross-border ventures in varied geographic locations in spite of a poor country image, is expected to provide rich insights on the influence of LOR on cross-border M&A.

The data are derived from the Thomson Reuters SDC Platinum Database, which has been used widely in the cross-border M&A academic literature (e.g., Contractor, Lahiri, Elango, & Kundu, 2014; Dikova et al., 2010; Sun et al., 2012). The current study focuses on publicly announced acquisitions made by Indian MNEs between 1999 and 2013. We chose the year 1999 because the number and value of CBAs made by Indian MNEs before 1999 were not substantive. This can be attributed to the regulatory restrictions on foreign exchange in place at that time. In 1999, with the introduction of the Foreign Exchange Management Act, external trade and payments were facilitated. Companies were then permitted to invest up to 100 % of their global depository receipts in CBAs (Gopinath, 2007). These supportive policy changes resulted in the value of CBAs by Indian MNEs crossing US$ 1 billion for the first time in 2001.

Given the hypotheses and the focus of the analysis on credibility and capability liabilities faced by EMNEs, the selection of the sample took the following criteria into account. First, since the unit of analysis is a firm, acquisitions by individuals were eliminated. Second, we excluded the category of "investor groups", as our unit of analysis is the EMNE, and investor groups are often formed of diverse groups and individuals, often of different nationalities. We excluded instances of round-tripping and those in which the acquirer and the target firm were from the same parent company. We also eliminated subsidiaries of foreign MNEs, as our focus was on Indian MNEs. After eliminating firms that did not match our selection criteria, we have a sample of 1864 acquisitions undertaken during the period of interest, 67 % of which were completed.

Measures

Our dependent variable is "closing the deal". This variable takes the value of 1 if the deal is recorded as being completed in the Thomson Database, as indicated by the variable "Date Effective".

Credibility liability is measured by two related, but different, concepts: legitimacy and status. We test our proposition by focusing on the difference in legitimacy between firms in the Indian IT and related industries and firms in other sectors. The IT and related sectors from India have gained global legitimacy at a slow, but steady, pace since the late 1990s, through measures such as off-shoring and listing on international stock exchanges. It was only after 2000, when Indian IT firms helped to tide over the global Y2K crisis, that they started to gain a taken-for-granted cognitive legitimacy (Pant & Ramachandran, 2012; Dossani & Kenney, 2006). Pant and Ramachandran (2012) posited that the Indian software industry attained a legitimacy threshold by the year 2004, based on inputs from senior executives in Indian software firms and a detailed analysis of reports by US technology analysts. To test our hypothesis, we compare the number of deals closed by Indian MNEs from the IT and related sectors with the number of deals closed by Indian MNEs from all other sectors. This is operationalized as a variable (AcquirorITLegit) that took the value 1 if the three-digit SIC code for the acquirer firm was either 737 or 738, and if the year of acquisition was 2005 or later. We specifically test for the success of acquisition completion post-2004, after Indian IT firms attained a necessary threshold of global legitimacy.

We have operationalized the role played by organizational learning in mitigating the impact of liability of origin in three different ways. We measure the depth of organizational learning in terms of the number of successful CBAs made by the acquiring firm prior to the focal acquisition (NumberAcqSucc), and the breadth of prior acquisition in terms of the number of countries, other than the focal country, in which the acquiring firm has had acquisition experience (GlobalExp). We also test for the impact of the relative absence of familiarity with a country's institutions and practices the first time an acquiring firm ventures into any country (CountryFirstTime). This liability is expected to be mitigated by the presence of a common language (in this case, English) for doing business (English).

We argue that the poor standard of living in India contributes to the low status of Indian MNEs. To measure status, we use the UNDP's Human Development Indices (HDI). HDI is a composite measure that takes health, education, and income into account. We operationalize the relative status difference in terms of the ratio of the HDI scores for the acquired firm's home country to that of India for the year in which the acquisition took place; specifically, the dummy variable HDIStatus takes the value of 1 if the relative HDI ratio is in the top quartile of its distribution, representing countries whose living standards are substantially higher than those of India. Ideally, status should be measured at the organizational level. In the extant literature, organizational status has commonly been estimated at the industry-nation level (e.g., Washington & Zajac, 2005; Jensen & Roy, 2008). Hence, selecting a measure for status that would hold across industries in different target countries proved a challenge. The variable PublicSector captures the relatively lower legitimacy of public sector enterprises from emerging markets such as India, given the experienced vulnerability of these public enterprises to political pressures and compulsions. Finally, we capture the mitigating impact (when present) of the relatively stronger institutions of regulatory governance in the country of the acquired firm through the corresponding Quality of Governance variable from the World Bank(QOG_RQE), and expect a positive relationship between QOG_RQE and the likelihood of deal completion.

We consider two control variables in our analysis: CashOnly and Related2. We expect deals involving only cash payments to have a higher probability of completion, given that deals involving stock payments can lead to delays in completion, as they are more complex due to the varying prices stocks; this can lead to renegotiations and delays in closing the deal (Dikova et al., 2010). The Related2 variable takes the value of 1 if the acquiring and acquired firms come from the same industry—operationalized as having the same two-digit SIC code. Acquisitions in a related industry are more likely to add to skills and expertise, and this experience in related industries may help to reduce the time required for closing the deal

Results

The dependent variable for our analysis is Deal Completion. While our sample covers 1864 CBAs by Indian firms during 1999–2013, many of the firms made multiple acquisitions over this period, with the mean number of acquisitions in the sample being 2.8. Table 7.1 describes the variables used in the analysis, Table 7.2 presents the summary statistics for the variables, and Table 7.3 presents the pair-wise correlations.

Given the binary nature of the dependent variable, we estimate three separate logit models. In Model 1, we include only the constant term, the year dummies, and our control variables. In Model 2, we add the capability liability-related explanatory variables, and in Model 3, we further add the credibility liability-related variables for the fully specified model. Table 7.4 presents details of the three analytic models.

The Wald χ^2 values for all three models are significant, indicating that each model has at least one variable that has significant explanatory power with respect to the probability of deal completion. The log-likelihoods for the three models indicate significant increases in the explanatory powers as we add the explanatory variables to the models, with the fully specified model having the best goodness of fit.

In line with our expectations, NumAcqSucc—our measure for the depth of the acquiring firm's acquisition experience—has a positive and significant relationship with the likelihood of deal completion in Models 2 and 3. Similarly, GlobalExp—our measure for the breadth of the acquiring firm's acquisition experience—offers significant explanatory power; as hypothesized, this relationship is negative, such that an increase in the number of countries (other than the focal country) in which the acquiring firm had attempted acquisitions is associated with a lower probability of deal completion. Taken together, these two results suggest that the impact of prior acquisition experience on the probability of completion of the current acquisition works in two important—and opposing—ways; depth helps and breadth hurts, marginal to the other variables in the model.

We had also posited that the probability of completion would be lower if the acquiring firm was entering a country for the first time (CountryFirstTime), but that this effect would be moderated by language

Table 7.1 Description of variables

Name	Description	Source
Dependent variable		
Deal completion *(Completed)*	Date effective Takes on a value of 1 if deal is closed "Deal Effective" Takes on a value of 0 if withdrawn	Thomson SDC Platinum
Independent variables		
First time country experience *(CountryFirstTime)*	Takes on a value of 1 for the first time the EMNE acquires a firm in a particular nation, 0 otherwise	Thomson SDC Platinum
Common business language *(English)*	Takes on a value of 1 if English is the official language in the target firm nation, 0 otherwise	
Number of successful cross-border acquisitions prior to focal acquisition *(NumberAcqSucc)*	The number of successful acquisitions undertaken by the EMNE prior to focal acquisition. A measure of the *depth* of acquisition experience	Thomson SDC Platinum
Geographic global experience *(GlobalExp)*	The number of countries other than focal country the EMNE has acquisition experience in before undertaking the focal acquisition. A measure of the *breadth* of acquisition experience	Thomson SDC Platinum
Public sector enterprise *(PublicSector)*	Takes a value of 1 if the EMNE belongs to public sector, 0 otherwise	Thomson SDC Platinum
Industry-specific legitimacy-building efforts *(AcquirorITLegit)*	Takes on a value of 1 if the firm is from the IT and related sectors (SIC Codes 737, 738) and the acquisition was announced after the year 2004	Thomson SDC Platinum
National quality of life status *(HDIStatus)*	Relative UNDP HDI of target firm host nation to India's HDI in the year of acquisition announcement	UNDP
Regulatory quality in target firm country *(QOG_RQE)*	The score for the regulatory quality WB QOG variable for the given target country and year of announcement of acquisition	World Bank Quality of Governance Indicators
Control variables		
All cash deal (*CashOnly)*	Takes the value 1 if the deal was all cash only	SDC Platinum
Industry relatedness *(Related2)*	Takes a value of 1 if the two-digit SIC code for acquirer firm's industry matches with that for the target firm	SDC Platinum

Constructed from http://en.wikipedia.org/wiki/List_of_territorial_entities_where_English_is_an_official_language.

Table 7.2 Summary statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
CashOnly	1864	0.14	0.35	0	1
Related	1852	0.61	0.49	0	1
Number of successful Acqns	1864	1.11	1.91	0	15
CountryFirstTime	1864	0.76	0.43	0	1
English	1864	0.61	0.49	0	1
GlobalExp	1864	1.02	1.76	0	12
QOG_RQE	1849	1.10	0.80	−2.08	2.16
AcquirorIT2004	1864	0.19	0.39	0	1
HDIStatus	1864	0.50	0.50	0	1
PublicSector	1864	0.06	0.25	0	1

commonalities (English) between the two countries; these hypothesized relationships are not supported by the data. The absence of the hypothesized negative impact of relative inexperience with the focal country was surprising, and merits further investigation. One possible explanation is that, while this was the first time the firm was acquiring in the focal country, it may have already been familiar with the country owing to earlier internationalization efforts, such as an earlier joint venture or subsidiary.

The results were in line with our expectations about the positive impact of the quality of regulatory governance (QOG_RQE) in the acquired firm's country (our capability argument), as well as the impact of the acquiring firm's belonging to the public sector (PublicSector) in India (our credibility argument).

Finally, the analysis also underscored the impact of the deal structure and industry relatedness on deal completion, with both of the control variables (CashOnly and Related2) offering significant explanatory power in the fully specified model.

Discussion

Our study makes several contributions to the literature on EMNE internationalization. We have integrated the existing frameworks on the disadvantages faced by EMNE and categorized these liabilities along two dimensions: capability liability, or the actual deficit of managerial

Table 7.3 Correlations

	CashOnly	Related2	NumAcq Succ	Country FirstTime	English	Global Exp	QOG_ RQE	AcquiIT	HDI Status
CashOnly	1.00								
Related2	0.07	1.0							
NumAcqSucc	0.03	0.08	1.00						
CountryFirstTime	–0.08	–0.07	–0.41	1.00					
English	0.11	0.01	–0.01	–0.17	1.00				
GlobalExp	–0.01	0.05	0.74	–0.20	–0.09	1.00			
QOG_RQE	0.11	–0.02	–0.03	–0.10	0.44	–0.19	1.00		
AcquirorIT2004	0.05	0.17	0.09	–0.12	0.18	–0.02	0.19	1.00	
HDIStatus	0.08	0.00	–0.03	–0.12	0.42	–0.12	0.59	0.13	1.00
PublicSector	–0.07	0.02	0.07	–0.01	–0.10	0.31	–0.33	–0.13	–0.13

Table 7.4 Acquisition completion results

Variables	Model 1 *Controls only*	Model 2 *Capability liabilities*	Model 3 *Capability and credibility liabilities*
Constant	0.362	0.168	0.388
	(0.386)	(0.472)	(0.483)
CashOnly	0.507**	0.436**	0.395**
	(0.156)	(0.161)	(0.162)
Related2	0.142	0.165	0.188*
	(0.103)	(0.106)	(0.110)
NumAcqSucc		0.221**	0.161**
		(0.048)	(0.048)
CountryFirstTime		0.056	–0.006
		(0.236)	(0.241)
CountryFirstTime*English		0.148	0.149
		(0.241)	(0.248)
English		–0.261	–0.192
		(0.254)	(0.263)
GlobalExp		–0.321**	–0.230**
		(0.049)	(0.051)
QOG_RQE		0.289**	0.211**
		(0.072)	(0.092)
AcquirorIT2004			–0.084
			(0.144)
HDIStatus			–0.119
			(0.167)
PublicSector			–1.584**
			(.257)
Cases	1852	1837	1837
Log likelihood	–1155.04	–1101.94	–1080.04
Wald χ^2	0.00	0.00	0.00

** $p<0.01$, * $p<0.05$

resources and capabilities, and credibility liability, or the lack of status and legitimacy. We extend the literature on M&A deal completion by building a conceptual model reflecting the influence of the liabilities of origin on deal completion. Existing studies on EMNE disadvantages have focused on financial performance in EMNE-driven cross-border M&As, rather than the processes. We adopt a novel approach by analyzing the influence of LOR on acquisition completion; this influence has not been considered in earlier work. Specifically, we introduce variables pertaining to legitimacy and status, along with both the depth and breadth of global experience, into the model.

Many of our hypotheses were supported by our analysis of the cross-border acquisitions done by Indian firms during 1999–2013. Our analysis showed that prior acquisition experience has the potential to mitigate the liability of origin, but that the learning may not necessarily be transferable across countries. What also stood out in our results was the relative lack of impact of credibility-linked liability. We suspect that this was probably more a matter of an absence of evidence, reflecting the nature of the variables we used to operationalize the construct, rather than an evidence of absence of the hypothesized effects themselves.

Limitations and Further Research

In the current study, status has been measured at the country level. In further research, a measure for status at the firm level could be generated and tested. The impact of status differences on post-integration could then be investigated. A high-status difference has been found to lead to deferential behavior by the lower status firm, and to fewer conflicts during post-acquisition (Cowen, 2012). This may be investigated empirically in the context of acquisitions by EMNEs. The current measure of capability liability can be made richer by testing additional firm-level proxies, such as R&D and marketing capabilities; investments in R&D and marketing have previously been found to relate positively to internationalization.

The current study has relied on secondary data for its analysis. Case studies and in-depth interviews could add invaluable insights. However, the fact that M&A processes are highly confidential, given their impact on share prices, employment, and industry structure, makes access to rich process data very challenging. Further, acquisitions are sometimes undertaken because of managerial hubris (Roll, 1986) or national pride (Hope, Thomas, & Vyas, 2011), and top managers are understandably reluctant to share unfavorable information about their strategies. Another factor is that Indian MNEs, like other EMNEs, are based in environments that may lack transparency. Since companies cannot rely on the institutional environment to protect their systems, they may rely more on protecting themselves by not openly sharing information. Thus, even while we recognize that this study would be enriched by primary data, we found that even if managers were willing to discuss sensitive issues relating to M&As off the record, they were reluctant to have the information made public, in spite of assurances of confidentiality.

Acquisition completion is just one of the steps in the M&A process. Further research could explore the influence of LOR on other stages. The current study has focused only on Indian MNE acquisitions. Future work could compare the influence of LOR across different emerging economies. The concept of LOR, we believe, is not relevant to M&As alone, but can also contribute to understanding the dynamics associated with other cross-border ventures, such as strategic alliances and joint ventures.

References

Alkire, T. D. (2014). The attractiveness of emerging market MNCs as employers of European and American talent workers: A multicultural study. *International Journal of Emerging Markets, 9*(2), 333–370.

Ball, S. B., & Eckel, C. C. (1996). Buying status: Experimental evidence on status in negotiation. *Psychology & Marketing, 13*(July), 381–405.

Bangara, A., Freeman, S., & Schroder, W. (2012). Legitimacy and accelerated internationalisation: An Indian perspective. *Journal of World Business, 47*(4), 623–634.

Barkema, H. G., Bell, J. H. J., & Pennings, J. M. (1996). Foreign entry, cultural barriers and learning. *Strategic Management Journal, 17*(December), 151–166.

Barkema, H. G., & Schijven, M. (2008). How do firms learn to make acquisitions? A review of past research and an agenda for the future. *Journal of Management, 34*(3), 594–634.

Bartlett, C., & Ghoshal, S. (2000). Going global: Lessons from late movers. *Harvard Business Review, 78*(2), 132–242.

Bitektine, A. (2011). Toward a theory of social judgments of organizations: The case of legitimacy, reputation, and status. *Academy of Management Review, 36*(1), 151–179.

Bonaglia, F., Goldstein, A., & Mathews, J. A. (2007). Accelerated internationalization by emerging markets' multinationals: The case of the white goods sector. *Journal of World Business, 42*(4), 369–383.

Brett, J. M., Friedman, R., & Behfar, K. (2009). How to manage your negotiating team. *Harvard Business Review, 87*(9), 105–109.

Cartwright, S., & Schoenberg, R. (2006). Thirty years of mergers and acquisitions research: Recent advances and future opportunities. *British Journal of Management, 17*(S1), S1–S5.

Child, J., & Rodrigues, S. B. (2005). The internationalization of Chinese firms: A case for theoretical extension? *Management and Organization Review, 1*(3), 381–410.

Contractor, F. (2013). "Punching above their weight" The sources of competitive advantage for emerging market multinationals. *International Journal of Emerging Markets, 8*(4), 304–328.

Contractor, F. J., Lahiri, S., Elango, B., & Kundu, S. K. (2014). Institutional, cultural and industry related determinants of ownership choices in emerging market FDI acquisitions. *International Business Review, 23*(5), 931–941.

Cowen, A. P. (2012). An expanded model of status dynamics: The effects of status transfer and interfirm coordination. *Academy of Management Journal, 55*(5), 1169–1187.

De Beule, F., & Duanmu, J. L. (2012). Locational determinants of internationalization: A firm-level analysis of Chinese and Indian acquisitions. *European Management Journal, 30*(3), 264–277.

Denk, N., Kaufmann, L., & Roesch, J. (2012). Liabilities of foreignness revisited: A review of contemporary studies and recommendations for future research. *Journal of International Management, 18*(4), 322–334.

DePamphilis, D. (2013). *Mergers, acquisitions, and other restructuring activities: An integrated approach to process, tools, cases and solutions* (5th ed.). Burlington, MA: Academic Press Advanced Finance Series, Elsevier.

Dikova, D., Sahib, P. R., & van Witteloostuijn, A. (2010). Cross-border acquisition abandonment and completion: The effect of institutional differences and organizational learning in the international business service industry, 1981–2001. *Journal of International Business Studies, 41*(2), 223–245.

Doh, J. P., Bunyaratavej, K., & Hahn, E. D. (2009). Separable but not equal: The location determinants of discrete services activities offshoring. *Journal of International Business Studies, 40*(6), 926–943.

Dossani, R., & Kenney, M. (2006). *The next wave of globalization: Relocating service provision to India*. Industry Studies Association. Working paper WP-2006-02, Stanford University, CA. Available online at http://isapapers.pitt.edu/68/2/2006-02_Dossani.pdf

Dowling, J., & Pfeffer, J. (1975). Organizational legitimacy: Social values and organizational behavior. *The Pacific Sociological Review, 18*(1), 122–136.

Dunning, J. H. (1988). The eclectic paradigm of international production: A restatement and some possible extensions. *Journal of International Business Studies, 19*(1), 1–31.

Eden, L., & Miller, S. R. (2001). *Opening the black box: The multinational enterprise and the costs of doing business abroad*. Best Paper Proceedings, Academy of Management, 1–6.

Eden, L., & Miller, S. R. (2004). Distance matters: Liability of foreignness, institutional distance and ownership strategy. *Advances in International Management, 16*, 187–221.

Fiol, C. M., & Lyles, M. (1985). Organizational learning. *The Academy of Management Review, 10*(4), 803–813.

Gopinath, S. (2007). Overseas investments by Indian companies—Evolution of policy and trends, Keynote Address at the Reserve Bank of India. Mumbai, India: http:/www.rbi.org. Accessed 5 July 2013.

Guillen, F. M., & Garcia-Canal, E. (2009). The American model of the multinational firm and the new multinationals from emerging economies. *Academy of Management Perspectives, 23*(2), 23–35.

Haleblian, J., & Finkelstein, S. (1999). The influence of organizational acquisition experience on acquisition performance: A behavioral learning perspective. *Administrative Science Quarterly, 44*(1), 29–56.

Hambrick, D. C. (1993). Relative standing: A framework for understanding departures of acquired executives. *Academy of Management Journal, 36*(4), 733–762.

Hambrick, D. C., & Cannella, A. A. (1993). Relative standing: A framework for understanding departures of acquired executives. *Academy of Management Journal, 36*(4), 733–762.

Hayward, M. L. (2002). When do firms learn from their acquisition experience? Evidence from 1990 to 1995. *Strategic Management Journal, 23*(1), 21–39.

Holl, P., & Kyriazis, D. (1996). The determinants of outcome in UK take-over bids. *International Journal of the Economics of Business, 3*(2), 165–184.

Hope, O. K., Thomas, W., & Vyas, D. (2011). The cost of pride: Why do firms from developing countries bid higher? *Journal of International Business Studies, 42*(1), 128–151.

Hymer, S. (1976). *The international operations of national firms—A study of direct foreign direct investment.* Cambridge, MIT Press. http://teaching.ust.hk/~mgto650p/meyer/readings/1/01_Hymer.pdf. Accessed 6 June 2013.

Jensen, M. (2008). The use of relational discrimination to manage market entry: When do social status and structural holes work against you? *Academy of Management Journal, 51*(4), 723–743.

Jensen, M., & Roy, A. (2008). Staging exchange partner choices: When do status and reputation matter? *Academy of Management Journal, 51*(3), 495–516.
Johanson, J., & Vahlne, J. E. (1977). The internationalization process of the firm—A model of knowledge development and increasing foreign market commitments. *Journal of International Business Studies, 8*, 23–32.
Karnani, A. (2012). Dubious value of international acquisitions by emerging economy firms : The case of Indian firms. In A. Gupta, T. Wakayama, & S. U. Rangan (Eds.), *Global strategies for emerging Asia*. San Francisco, CA: Jossey Bass.
King, D. R., Dalton, D. R., Daily, C. M., & Covin, J. G. (2004). Meta-analyses of post-acquisition performance: Indications of unidentified moderators. *Strategic Management Journal, 25*(2), 187–200.
Klossek, A., Linke, B. M., & Nippa, M. (2012). Chinese enterprises in Germany: Establishment modes and strategies to mitigate the liability of foreignness. *Journal of World Business, 47*(1), 35–44.
Kostova, T., & Zaheer, S. (1999). Organizational legitimacy under conditions of complexity: The case of the multinational enterprise. *Academy of Management Review, 24*(1), 64–81.
Kumar, N. (2008). Internationalization of Indian enterprises: Patterns, strategies, ownership advantages, and implications. *Asian Economic Policy Review, 3*(2), 242–261.
Lall, S. (1982). The emergence of third world multinationals: Indian joint ventures overseas. *World Development, 10*(2), 127–146.
Larsson, R., & Finkelstein, S. (1999). Integrating strategic, organizational, and human resource perspectives on mergers and acquisitions: A case survey of synergy realization. *Organization Science, 10*(1), 1–26.
Lecraw, D. (1977). Direct investment by firms from less developed countries. *Oxford Economic Papers, 29*(3), 442–457.
Levitt, B., & March, J. G. (1988). Organizational learning. *Annual Review of Sociology, 14*(May), 319–340.
Liou, R., Rose, A. S., & Ellstrand, A. E. (2012). Multinational corporations as agents of globalization: Conflicting institutional demands and the isomorphism of global markets. In T. M. Devinney, T. Pedersen, & L. Tihanyi (Eds.), *Advances in international management* 25 (25). New York: Emerald.
Luo, Y., & Tung, R. L. (2007). International expansion of emerging market enterprises: A springboard perspective. *Journal of International Business Studies, 38*(4), 481–498.

Madhok, A., & Keyhani, M. (2012). Acquisitions as entrepreneurship: Asymmetries, opportunities, and the internationalization of multinationals from emerging economies. *Global Strategy Journal*, *2*(1) 40, 26–40.
Marks, M. L., & Mirvis, P. H. (2011). Merge ahead: A research agenda to increase merger and acquisition success. *Journal of Business and Psychology, 26*(2), 161–168.
Mathews, J. A. (2006). Dragon multinationals: New players in 21st century globalization. *Asia Pacific Journal of Management, 23*(1), 5–27.
Mezias, J. M. (2002). How to identify liabilities of foreignness and assess their effects on multinational corporations. *Journal of International Management, 8*(3), 265–282.
Morosini, P., Shane, S., & Singh, H. (1998). National cultural distance and cross-border acquisition performance. *Journal of International Business Studies, 29*(1), 137–158.
Nadolska, A., & Barkema, H. G. (2007). Learning to internationalise: The pace and success of foreign acquisitions. *Journal of International Business Studies, 38*(7), 1170–1186.
North, D. (1990). *Institutions, institutional change, and economic performance*. New York: Cambridge University Press.
Pant, A., & Ramachandran, J. (2012). Legitimacy beyond borders: Indian software services firms in the United States, 1984 to 2004. *Global Strategy Journal, 2*(3), 224–243.
Parameswaran, R., & Pisharodi, R. M. (1994). Facets of country of origin image: An empirical assessment. *Journal of Advertising, 23*(1), 43–56.
Peng, M. W. (2012). The global strategy of emerging multinationals from China. *Global Strategy Journal*, *2*(2) 2, 97–107.
Pereira, A., Hsu, C.-C., & Kundu, S. K. (2005). Country-of-origin image: Measurement and cross-national testing. *Journal of Business Research, 58*(1), 103–106.
Peterson, R. A., & Jolibert, A. (1995). A meta-analysis of country of origin effects. *Journal of International Business Studies, 26*(4), 883–900.
Podolny, J. M., & Phillips, D. J. (1996). The dynamics of organizational status. *Industrial and Corporate Change, 5*(2), 453–472.
Pradhan, J. P. (2007). *Trends and patterns of overseas acquisitions by Indian multinationals.* MPRA Paper. http://mpra.ub.uni-muenchen.de/12404/
Ramachandran, J., & Pant, A. (2010). The liabilities of origin: An emerging economy perspective on the costs of doing business abroad. In T. M. Devinney, T. Pedersen, & L. Tihanyi (Eds.), *Advances in international management*, 23. New York: Emerald.

Ray, S., & Gubbi, S. R. (2009). International acquisitions by Indian firms: Implications for research on emerging multinationals. *Indian Journal of Industrial Relations, 45*(1), 11–26.

Roll, R. (1986). The hubris hypothesis of corporate takeovers. *Journal of Business, 59*(2), 197–216.

Rugman, A. M., & Li, J. (2007). Will China's multinationals succeed globally or regionally? *European Management Journal, 25*(5), 333–343.

Rugman, A. M., & Verbeke, A. (2003). Extending the theory of the multinational enterprise: Internalization and strategic management perspectives. *Journal of International Business Studies, 34*(2), 125–137.

Sauder, M., Lynn, F., & Podolny, J. M. (2012). Status: Insights from organizational sociology. *Annual Review of Sociology, 38*(1), 267–283.

Scott, W. R. (1995). *Institutions and organizations* (1st ed.). Thousand Oaks, CA: Sage.

Sebenius, J. K. (2002). The hidden challenge of cross border negotiations. *Harvard Business Review, 80*(3), 76–85.

Semadeni, M., Fraser, D. R., & Lee, D. S. (2008). Fight or flight: Managing stigma in executive careers. *Strategic Management Journal, 29*(5), 557–567.

Sethi, D., & Judge, W. (2009). Reappraising liabilities of foreignness within an integrated perspective of the costs and benefits of doing business abroad. *International Business Review, 18*(4), 404–416.

Shimbori, M., Ikeda, H., Ishida, T., & Kondô, M. (1963). Measuring a nation's prestige. *American Journal of Sociology, 69*(1), 63–68.

Shrivastava, P. (1986). Postmerger integration. *Journal of Business Strategy, 7*(1), 65–76.

Sirower, M. (1997). *The synergy trap: How companies lose the acquisition game*. New York: The Free Press.

Smith, C., & Meiksins, P. (1995). System, society and dominance effects in cross-national organisational analysis. *Work, Employment & Society, 9*(2), 241–267.

Suchman, M. C. (1995). Managing legitimacy: Strategic and institutional approaches. *Academy of Management Review, 20*(3), 571–610.

Sun, S. L., Peng, M. W., Ren, B., & Yan, D. (2012). A comparative ownership advantage framework for cross-border M&As: The rise of Chinese and Indian MNEs. *Journal of World Business, 47*(1), 4–16.

Thite, M. (2012). Strategic global human resource management: Case study of an emerging Indian multinational. *Human Resource Development International, 15*(2), 37–41.

Thomas, D. E., Eden, L., Hitt, M. A., & Miller, S. R. (2007). Experience of emerging market firms: The role of cognitive bias in developed market entry and survival. *Management International Review, 47*(December), 845–867.
Tung, R. L. (2007). The human resource challenge to outward foreign direct investment aspirations from emerging economies: The case of China. *International Journal of Human Resource Management, 18*(5), 868–889.
UNCTAD. (2014). World investment report 2014: *Investing in the SDGs: An action plan*. New York: UNCTAD. http://www.undp.org
UNCTAD. (2015). *World investment report 2015: Reforming international investment governance*. New York: UNCTAD. http://www.undp.org
Vermeulen, F., & Barkema, H. (2001). Learning through acquisitions. *Academy of Management Journal, 44*(3), 457–476.
Washington, M., & Zajac, J. E. (2005). Status evolution and competition: Theory and evidence. *Academy of Management Journal, 48*(2), 282–296.
Xu, D., & Shenkar, O. (2002). Institutional distance and the multinational enterprise. *Academy of Management Review, 27*(4), 239–247.
Zaheer, S. (1995). Overcoming the liability of foreignness. *Academy of Management Journal, 38*(2), 341–363.
Zhang, J., Zhou, C., & Ebbers, H. (2011). Completion of Chinese overseas acquisitions: Institutional perspectives and evidence. *International Business Review, 20*(2), 226–238.

8

International Strategic Alliances for Innovation in the Indian Biotechnology Industry

Thomas Joseph and S. Raghunath

Introduction

Innovation is increasingly crucial for firms to cope with rapid changes in technology, preferences of customers, increasing competition, shortening product life cycles, and growing product complexity. Innovations have in fact become the key to survival and growth (Tidd, Bessant, & Pavitt, 2001; Eiriz, Vasco, Faria, & Barboza, 2013). Owing to the limitations of internal knowledge resources, firms are moving beyond their own resources and seeking to acquire ideas from others (David & Foray, 2003). Collaboration and alliances have become popular as firms seek to

T. Joseph (✉)
Indian Institute of Management Udaipur, Udaipur, India
e-mail: thomas.joseph@iimu.ac.in

S. Raghunath
Indian Institute of Management Bangalore, Bengaluru, India
e-mail: Srnathiimb@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_8

achieve higher returns on R&D as well as operations (Hagedoorn, 2002). Alliances provide access to complementary skills and capabilities (Teece, 1986; Ahuja, 2000) and also bring economies of scale and scope.

While a great deal of work has been done on internal R&D innovations (Inkpen, 2002; Narula, 2004; Narula & Zanfei, 2005; Vega Jurado & Gracia, 2008), little has been done to understand the innovations in business models through alliances. This chapter focuses on those firms with an intent to build new business models by appropriating skills, technology, and other strategic capabilities from partners and to create a sustainable business model through such alliances.

In the emerging biotechnology industry, innovation is the key to survival and growth (Baum, Calabrese, & Silverman, 2000). We have specifically chosen to look at the Indian biotechnology industry for the first part of this research to study how business model innovations happen and how innovations happen in the biotechnology industry (Palnitkar, 2005).

Considering the importance given to the subject of innovation in recent journal articles and popular magazines (e.g., Ruef, 2002; Stuart, 2000; Vasco, Faria, & Barbosa, 2013), a study to understand alliances designed for future innovations is timely and relevant. Our belief is that the alliance and innovation constructs and their interrelationship will prove helpful and relevant for practicing managers.

In the biotechnology industry, survival depends directly on the capacity to innovate (Powell, Koput, Smith-Doerr, & Owen-Smith, 1999). In fact, almost all firms in this sector target innovation as a natural process. However, small firms have limited resources for technology and knowledge development (Damanpour, 1991). Now the growing trend among biotech firms in general is a move to acquire intellectual assets from external sources (Bowonder, Racherla, Mastakar, & Krishnan, 2005; Walker, Kogut, & Shan, 1997). In a survey of biotechnology firms, gaining access to a partner's R&D facilities and expertise was cited as one of the main motives behind strategic alliance formation (Forrest & Martin, 1992). Since the resources needed for innovation are so expensive and extensive, alliances have actually become the norm within the biotechnology industry (George, 2002).

In the Indian context, there have been studies on the R&D, knowledge base, market sales, commercialization, and alliance of bio-pharmaceutical firms (Ghosh, 2004; Ramani, 2002; Sandhya &

Visalakshi, 2000; Visalakshi & Sandhya, 1997). Also, using industry-specific databases, the structure of biotechnology firms in general has been analyzed in terms of the parameters of size, activity profile, product portfolio, R&D patterns, and alliances, among others. These studies did not specifically focus on the aspect of "alliances for innovation" in India and hence this study addresses a significant gap in literature. In the second part of the chapter, we focus on the success and sustainability of these strategic alliances.

Research Question

The notion of alliances as a vehicle for learning is present in a large stream of literature, including a significant body of conceptual and empirical work (Kale, Singh, & Perlmutter, 2000). Alliances may even generate knowledge that can be used by parent firms to enhance innovations in strategic and operational areas unrelated to the alliance activities (Khanna, Gulati, & Nohria, 1998). This type of knowledge is referred to as alliance knowledge.

We assume that organizational learning is both a function of access to knowledge and the capabilities for using and building on such knowledge (Powell, Koput, & Smith-Doerr, 1996). We also adopt the view that alliances are mixed-motive structural forms. As Inkpen (2002) suggests, in order to learn through an alliance, a firm must have access to partner knowledge and must work closely with its partner. Therefore, both collaborative processes and firm-specific factors must be understood. Our research seeks to determine the different factors which may optimize learning and hence innovation. As Inkpen (2002) commented on alliance learning research, "Now that there is a solid base of antecedents research, the next step is theoretical and empirical work that integrates the diverse perspectives and establishes some causal links across the variables". A deeper understanding of such causal links could allow firms to systematically structure and manage alliances that are optimized for learning and innovation.

This chapter attempts to identify *the firm-specific factors which optimize the internalization of new skills and capabilities and increase the possibility of recombining these skills and capabilities to generate the innovation required for competitive advantage.*

Methodology

The population of the current study consists of biotechnology firms in India and their alliances. The selection of organizations that fall into the category of biotechnology firms is as per the definition of the Department of Biotechnology, New Delhi. The list of the biotechnology firms for survey and further investigation has been primarily derived from the latest *Directory of Biotechnology Industries and Institutions in India* brought out by Biotech Consortium India Ltd (BCIL), Department of Biotechnology, New Delhi. The Directory contains alphabetically arranged list of biotechnology firms in India along with their brief profile. The profile contains details about the firm's operational sector, state, establishment year, products developed, alliances, and so on. Then companies profiled with alliances in the directory were contacted to understand whether they were having alliances as per the definition and scope mentioned in Chap. 2 of the directory. Those who confirmed that they are having such alliances were targeted as the possible data point.

The list of companies used for sampling accounted for more than 70 % of the biotechnology revenues in the year 2005–2006. The number of alliances according to the BCIL directory itself is more than 200. More than 50 % of the total alliances in this industry consist of the sampled companies. The surveyed sample consists of seven out of top ten companies by revenue and four out of top five companies by alliances. This sample was representative of the population of Indian biotechnology industry.

Quantitative data were collected and subjected to analysis. After testing the hypotheses, the samples used in the quantitative survey were scrutinized further to find those that best matched the context targeted by our research question. Five companies were selected, and the top management representative who was highly knowledgeable about the firm's alliances was then approached for a detailed interview. Following these five interviews, the most appropriate case was selected for a final round of interviews. This company had many alliances, but the interviews investigated one specific alliance that was extremely relevant to our research question. Triangulation of the facts was carried out by means of a separate interview with that firm's Chairman and Managing Director (CMD). These interviews provided supportive evidence for the research hypothesis as well as significant insights to explain the results from the quantitative survey method.

Sample Description

Table 8.1 About the survey

Total number of firm-alliances	50
Total number of firms	21
Number of firm-alliances with more than 5 years in existence	26
Number of firm-alliances with less than 5 years in existence	24
Lowest level of employees interviewed	Middle management and Alliance Head
Total number of senior management participated	19
Total number of middle management personnel as Alliance Heads	4
Number of top management personnel participated	27
Number of bio-pharma samples	27
Number of bio-agri companies	3
Number of bio-services companies	20

Interviews

Table 8.2 Interviews

Total number of interviews conducted	6
Total number of companies	5
Minimum level of the interviewee	General Manager & Alliance Head
Highest level of interviewee	CMD
Minimum time for interview	38 minutes
Maximum time taken for interview	2 hours 15 minutes
Place of interviews	Interviewee's office

Data Collection

Data were collected through a single observer key informant response (Sethuraman, Anderson, & Narus, 1988). A key informant is a person (or group of persons) who has unique skills or professional background

Table 8.3 Advantages and disadvantages of using key informants

Advantages	Disadvantages
Information concerning causes, reasons, and/or best approaches from an "insider" point of view	Time required to select and get commitment may be substantial
Advice/feedback increases credibility of study	Relationship between evaluator and informants may influence type of data obtained
Pipeline to pivotal groups	Informants may interject own biases and impressions
May have side benefit to solidify relationships between evaluators, clients, participants, and other stakeholders	May result in disagreements among individuals leading to frustration/conflicts

related to the issue/intervention being evaluated, is knowledgeable about the project participants, or has access to other information of interest to the evaluator. A key informant can also be someone who captures the essence of what the participants say and do. Key informants can help the evaluation team better understand the issue being evaluated, as well as the project participants, their background, behavior, attitude, and any language or ethnic considerations. They can offer expertise beyond the evaluation team. They are also very useful for assisting with the evaluation of curricula and other educational materials. Key informants were surveyed individually for this research. The advantages and disadvantages of using key informants are outlined in Table 8.3 above.

This study used responses from only one side of the collaborative arrangement. Given that the CEO or the Alliance Head is the final arbiter of the resource allocation in this situation, we focused on responses from the CEO or the Alliance Head.

Findings

Growth Potential/Opportunities

In the cases studied, the alliance managers were of the opinion that immediate opportunity creates a strong impetus for learning from the partner. If opportunity is visible, firms enter into an alliance to shorten learning time. Even when a firm commitment for alliance agreement is possible, firms do not take the initiative until opportunities are quite visible (Sarkar, Echambadi, & Harrison, 2001). One Managing Director described how a competitor sat on a licensing agreement for a year and canceled the deal without recognizing the future opportunity. Later the competitor's Managing Director regretted his lack of vision. The ability to recognize the urgency of opportunities seems to be a function of domain knowledge and expertise.

Technological Competence and Learning Capacity

High levels of technological competence and learning capacity (Cohen & Levinthal, 1990) were identified as important by many CEOs. The non-availability of highly qualified human resources thus poses a problem to the Indian biotechnology industry. One of the general managers pointed out that "if the level of technological competence between the two parties is very high, then the knowledge transfer is quite low". A higher level of technological competence fosters the internalization of knowledge and skills with less effort.

Risk-Taking Ability

The ability to take risk is one of the major moderators in the context of learning for innovation (Simonin, 1999). If the opportunity is clearly visible, any decision-maker can make a rational choice. But when opportunities are not so evident, the risk taker may eventually become a winner. The problem with a risk-taking attitude, as pointed out by one of the alliance managers, is the chance of losing the partner's trust over intellectual property issues if the technology is not so easy to protect from being copied. The partner may view with suspicion the other firm's risk-taking initiative to learn. This may lead to lesser sharing of partner knowledge. "Once the IP issues are amicably settled and the agreement is reached, the partners may share knowledge quite easily", said one of the Managing Directors. So this moderating factor can have nonlinear type of relationship with learning for innovation.

Organizing Cost

When the organizing cost, which consists of time and other resources, exceeds the initial target, top management's attention would be diverted to cost control initiatives. This has an adverse effect on learning intent. As attention gets diverted, the internalization initiative takes a back seat. This was noted during interviews by several top management representatives. But knowing how to measure the cost of organizing alliance comes through experience, as one alliance manager pointed out. So keeping a tab on this issue becomes extremely difficult.

Structure and Propensity for Change

Burns and Stalker (1961) defined organic and mechanistic structures and their relation with innovation explored. The organic structures, having characteristics of flexibility, fluidity, and informality, were associated with a firm's plan for making innovations (Guimera, Uzzi, Spirro, & Amaral, 2005). The mechanistic structure was associated with innovation through external means. But here the question was how the structure of the alliance would impact the individual firm's learning for innovation.

Several insights were gleaned from our research. First, an alliance may go through different kinds of structures over the course of its life cycle. The IP-related uncertainty necessitates having a formal, rigid, and stable structure during the initial years of the alliance. Once IP issues are discussed and settled, then an organic structure becomes a possibility. A top management representative suggested the possibility of having an S-curve relationship between organicity of structure and internalization of knowledge. However, all the interviews stressed the need for an organic structure with certain activities such as recombination of knowledge to create further ideas. However, according to the top management experts interviewed, generating an application-oriented solution again required a formal, stable structure within the firm.

The Intensity of the Exchange: Communication

The intensity of knowledge exchange is an important factor in the innovation process that needs to be separately understood and measured. With the evolution of information technology, firms can now have a mechanistic structure and yet manage through open and informal communication. "The importance of open communication is very high when you have an idea which gives an 'Aha!' feeling", opined one of the alliance heads. The informal exchange is also important considering the fact that many ideas evolving in an innovation process may be not worth putting into formal channels. "But it gives a lot of satisfaction to the scientists", noted another CEO. Many indicated the necessity of having a very formal network to ensure smooth and reliable information dissemination. So the importance of maintaining an open, informal communication channel along with a formal mechanism nurtures the innovation process when this route is chosen.

Internalization and Reduction in Dependence

Internalization and dependency reduction emerged as the dominant factors leading to innovation when the strategic intent was to learn through an alliance.

Firm-specific factors that affected internalization were (a) learning capacity, (b) technological competence, and (c) the ability to take risk. The interviews highlighted the necessity of a high learning capacity for the whole team and a high technological competence for at least a few in the alliance team from the learning firm's side to attain a high degree of internalization.

Governance Cost

The governance cost and its relation with internalization, was well established. Most of the interviewees asserted that governing cost was a good indicator of how successfully the intended outcomes had been achieved.

When the governing cost was higher than expected or planned, top management's attention was diverted to cost control measures and learning took a back seat. This result was therefore pertinent to planning and executing the alliance for learning.

Yet, very few companies systematically organize their alliances. This is first a failure to rigorously organize and measure the given firm's activities and performance related to the alliance. Second, companies often fail to recognize performance patterns across their alliance portfolios—patterns concerning particular deal structures, types of partners, or functional tasks. A failure to spot and fix recurring problems can be costly. Finally, only a few senior management teams know whether the alliance portfolio as a whole really supports corporate strategy.

Inkpen (1996) noted that the cost of knowledge creation is an important issue when we aim to learn through alliances. The decision to initiate knowledge creation efforts should be balanced by the cost. In many cases, early estimates are exceeded because the partners fail to consider the expenses of coordinating their activities or the value of senior management's time. As the organizing cost of an alliance increases, the attention of alliance managers shifts to controlling those costs instead of learning for innovation (Inkpen & Ross, 2001).

When the alliance mechanism stabilizes with respect to financial and relational matters, it releases more time and effort to learning from the other partner.

The study revealed that structural organicity has a positive effect on internalizing knowledge. Organicity has long been associated with innovation (Burns & Stalker, 1961; Damanpour, 1991). It has generally been expected that the flexible, fluid organic structure would be better suited to innovations.

The revolution in information technology and its possible use in the innovation through alliance mechanism was another area targeted by the study. The qualitative study revealed the importance of having an open communication channel to support a free flow of ideas across the alliance while keeping the option of a formal mechanism to ensure smooth flow of certain information. The availability of suppliers and customers and the possible worth of the targeted innovation had a bearing on the internalization process, as revealed by top management representatives.

The horizon can be varied according to the vision of the top management representatives who pursue this innovation path.

Strategic Intent and Choice of Governance Form

From our study, it was understood that strategic intent was closely related to the choice of governance form. If both internalization and dependency reduction were essential parts of the objectives, a joint venture was not found to be optimal form. One Managing Director observed, "if the partner had a mechanism to generate innovations, taking over that firm could kill the innovation process". She compared the situation with that of killing the golden goose. If sharing of knowledge and generating innovation was acceptable to both the partners, a joint venture could be considered ideal. If the strategic intent was to learn about a particular platform so that the target firm would generate its own innovations internally, a contractual relation could have been more appropriate.

Conclusion

The success of an alliance meant for innovation was found to be a function of the variables discussed above. From the factor analysis of those variables, two factors emerged. We have called these factors the "Capability to Explore" and the "Opportunity to Exploit". The "Capability to Explore" was determined by learning capacity, technological competence, and risk-taking ability. The "Opportunity to Exploit" is determined by growth potential and governing cost. Loading these factors into a 2x2 matrix (shown in Fig. 8.1) offers different factor combinations and a practical understanding of how the "alliances for innovation" strategy can be operationalized.

The qualitative research further led to spillover results. Many interviewees linked the relationship between alliance success and the partners' complementary strategic intents. They also mentioned the role of operational compatibility between partners. We have structured these dimensions into the framework given in Fig. 8.2. When partners exhibit high strate-

Opportunity to Exploit	High	Improvements	Innovation
	Low	Status quo	Invention
		Low	High
		Capability to Explore	

Fig. 8.1 Exploration and exploitation

Operational Compatibility	High	Opportunism	Successful Continuation
	Low	Unsuccessful Termination	Troubled Alliances
		Low	High
		Strategic complementarities	

Fig. 8.2 Compatibility and complementarity

gic complementarity and operational compatibility, it leads to a successful alliance (Masanell & Yoffie, 2005; Microsoft and HP Alliance, n.d.). At the other end of the spectrum, operational incompatibility and conflicting strategic intent would lead to unsuccessful alliance and its eventual termination. When complementary intentions are high and operational compatibility is low, firms continue the relationship for long-term benefits. However, these alliances could have operational issues and disputes. When complementary intent is absent, firms exhibit opportunistic behavior.

Our study has some limitations. First, in our study, we have collected the data concerning perspectives of the partner who gets into the alliance with innovation intent. However, it would have been valuable if we could get the perspectives of the other partner as well. But gathering such information was extremely challenging with many partners originating from different countries. Second, because there are only a limited number of firm-alliances, the results may not be generalizable. Third, the context chosen was the Indian Biotechnology Industry. So the results may be applicable to choose similar contexts and not to others. The effect of life cycle stage of alliance can be explored through a longitudinal study.

References

Ahuja, G. (2000). Collaboration networks, structural holes, and innovation: A longitudinal study. *Administrative Science Quarterly, 45*(3), 425–455.

Baum, J. A. C., Calabrese, T., & Silverman, B. S. (2000). Don't go it alone: Alliance network composition and startups. Performance in Canadian biotechnology. *Strategic Management Journal, 21*(3), 267–294.

Bessant, T. J., & Pavitt, K. (2001). *Managing innovation*. Chichester: Wiley.

Bowonder, B., Racherla, J. K., Mastakar, N. V., & Krishnan, S. (2005). R&D spending patterns of global firms. *Research Technology Management, 48*(5), 51–59.

Burns, T., & Stalker, G. M. (1961). *The management of innovation*. London: Tavistock.

Cohen, W. M., & Levinthal, D. A. (1990). Absorptive capacity: A new perspective on learning and innovation. *Administrative Science Quarterly, 35*(1), 128–152.

Damanpour, F. (1991). Organizational innovation: A meta-analysis of effects of determinants and moderators. *Academy of Management Journal, 34*(3), 555–590.

David, P., & Foray, D. (2003). Economic fundamentals of the knowledge society. *Policy Futures in Education, 1*(1), 20–49.

Eiriz, V., Barbosa, N., & Lima, V. (2013). Differences of absorptive capacity between firms within a cluster. *Transformations in Business & Economics*, *12*(3), 203–214.

Forrest, J. E., & Martin, M. J. C. (1992). Strategic alliances between large and small research intensive organizations: Experiences in the biotechnology industry. *R&D Management, 22*(1), 41–53.

George, G., Zahra, S. A., & Wood, D. A. (2002). The effects of business-university alliances on innovative output and financial performance: A study of publicly traded biotechnology companies. *Journal of Business Venturing, 17*(6), 577–609.

Ghosh, P. K. (2004). The role of alliance in modern biotech industries in developing countries. *Current Science, 87*(4), 874–884.

Guimera, R., Uzzi, B., Spirro, J., & Amaral, L. A. N. (2005). Team assembly mechanisms determine collaboration network structure and team performance. *Science, 308*(5722), 697–702.

Hagedoorn, J. (2002). Inter-firm R&D partnerships: An overview of major trends and patterns since 1960. *Research Policy, 31*(2002), 477–492.

Inkpen, A. C. (1996). Creating knowledge through collaboration. *California Management Review, 39*(1), 123–140.

Inkpen, A. C. (2002). Learning, knowledge management, and strategic alliances: So many studies, so many unanswered questions. In F. J. Contractor & P. Lorange (Eds.), *Cooperative strategies and alliances* (pp. 267–289). Amsterdam: Elsevier Science.

Inkpen, A. C., & Ross, J. (2001). Why do some strategic alliances persist beyond their useful life? *California Management Review*, *44*(1), 132–148.

Kale, P., Singh, H., & Perlmutter, H. (2000). Learning and protection of proprietary assets in strategic alliances: Building relational capital. *Strategic Management Journal, 21*(2000), 217–237.

Khanna, T., Gulati, R., & Nohria, N. (1998). The dynamics of learning alliances: Competition, cooperation, and relative scope. *Strategic Management Journal, 19*(3), 193–210.

Masanell, R. C., & Yoffie, D. B. (2005). *Wintel: Cooperation or conflict*. Boston: HBS working paper 05-083.

Microsoft & HP Alliance. (n.d.). Retrieved February 2013, from Microsoft: http://www.microsoft.com/enterprise/partners/hp.aspx#fbid=dAo8bEKE7Z

Narula, R. (2004). Understanding absorptive capacities in an innovation systems context: Consequences for economic and employment growth. MERIT Research Memorandum 2004-003.

Narula, R., & Zanfei, A. (2005). Globalisation of innovation: The role of multinational enterprises. In J. Fagerberg, D. C. Movery, & R. R. Nelson (Eds.), *The Oxford handbook of innovation* (pp. 318–348). Oxford: Oxford University Press.

Palnitkar, U. (2005). Growth of Indian biotech companies, in the context of the international biotechnology industry. *Journal of Commercial Biotechnology, 11*(2), 146–154.

Powell, W. W., Koput, K. W., & Smith-Doerr, L. (1996). Interorganizational collaboration and the locus of innovation: Networks of learning in biotechnology. *Administrative Science Quarterly, 41*(1), 116–145.

Powell, W. W., Koput, K. W., Smith-Doerr, L., & Owen-Smith, J. (1999). Network position and firm performance: Organizational returns to collaboration in the biotechnology industry. *Research in the Sociology of Organizations, 16*(1), 129–159.

Ramani, S. V. (2002). Who is interested in biotech? R&D strategies, knowledge base and market sales of Indian biopharmaceutical firms. *Research Policy, 31*(3), 381–398.

Ruef, M. (2002). Strong ties, weak ties and islands: Structural and cultural predictors of organizational innovation. *Industrial and Corporate Change, 11*(3), 427–449.

Sandhya, G. D., & Visalakshi, S. (2000). R&D capability and alliance formation in the pharmaceutical industry in India. *Science and Public Policy, 27*(2), 109–121.

Sarkar, M. B., Echambadi, R., & Harrison, J. S. (2001). Alliance entrepreneurship and firm market performance. *Strategic Management Journal, 22*(6–7), 701–711.

Setguraman, R., Anderson, J. C., & Narus, J. A. (1988). Partnership advantage and its determinants in distributor and manufacturer working relationships. *Journal of Business Research*, *17*, 327–347.

Simonin, B. L. (1999). Ambiguity and the process of knowledge transfer in strategic alliances. *Strategic Management Journal, 20*(7), 595–623.

Stuart, T. E. (2000). Interorganizational alliances and the performance of firms: A study of growth and innovation rates in a high-technology industry. *Strategic Management Journal, 21*(8), 791–811.

Teece, D. J. (1986). Profiting from technological innovation: Implications for integration, collaboration, licensing and public policy. *Research Policy, 15*(6), 285–305.

Vasco, E., Faria, A., & Barbosa, N. (2013). Firm growth and innovation. *Innovation: Management, Policy and Practice, 15*(1), 97–111.

Vega-Jurado, J., Gutiérrez-Gracia, A., Fernández-de-Lucio, I., & Manjarrés-Henriquez, L. (2008). The effect of external and internal factors on firms' product innovation. *Research Policy*, *37*(4), 616–632.
Visalakshi, S., & Sandhya, G. D. (1997). An analysis of biotechnology and non-biotechnology R&D capabilities in the Indian pharmaceutical industry. *R&D Management, 27*(2), 177–180.
Walker, G., Kogut, B., & Shan, W. (1997). Social capital, structural holes and the formation of industry network. *Organizational Science, 8*(2), 109–125.

Part III

Entrepreneurship and Exporting

9

Emerging-Market Born Globals: The Influence of Product-Related Factors on Internationalization Mode in the Indian Apparel Industry

S. Raghunath and Krishna Kumar Balaraman

Introduction

The internationalization of emerging-market firms is an area of increasing interest to researchers, as more of the emerging economies become active players in international trade and the global economy (Gaur & Kumar, 2010). In keeping with the trend of increasing internationalization of emerging markets, the Indian economy has been rapidly internationalizing for the past few decades, and this has led to the rise of born global firms in various industries. Studies indicate that there is a growing trend of new ventures going global at, or near, startup (e.g., Oviatt & McDougall, 1994; Shrader, Oviatt & McDougall, 2000), having a strong

S. Raghunath
Indian Institute of Management Bangalore, Bengaluru, India

K.K. Balaraman (✉)
Indian Institute of Technology Madras, Chennai, India
e-mail: balakk@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_9

international vision right from inception (Oviatt & McDougall, 1997), and focusing on meeting the demands of markets that are inherently international (Oviatt & McDougall, 1997). The study of born global companies, which internationalize rapidly, almost from inception, has been of interest for the past several decades (e.g., Johanson & Vahlne, 2009; Knight, Madsen & Servais, 2004; Rialp, Rialp & Knight, 2005; Persinger, Civi & Vostina, 2007; Melén & Nordman, 2009; Kim, Basu, Naidu & Cavusgil, 2011). While there are many studies on the initial internationalization approach of born globals, there seems to be limited research on the continued internationalization of these companies (Melén & Nordman, 2009). Further, the influence of product-related factors on the choice of internationalization modes, especially for emerging-market born globals, has not been heavily researched. We have investigated the internationalization modes of Indian-born global organizations in the apparel industry, to provide a better understanding of product life-cycle influences on choices related to internationalization.

In the Indian context, there are some studies on internationalization and born globals (e.g., Elango & Pattnaik, 2007; Verma, 2011; Kim, Basu, Naidu & Cavusgil, 2011). However, there are very few in-depth studies on the internationalization modes of born globals from India (Kim et al., 2011; Varma, 2011). This chapter addresses that gap by studying born globals in the Indian apparel industry. The longitudinal study attempts to understand the rationale behind the internationalization modes used by these organizations, and the product-related influence on the choices made by these organizations in the process of their internationalization efforts.

Johanson and Vahlne (1977) suggested that internationalization is the product of a series of incremental decisions. The same authors revisited the Uppsala model (Johanson & Vahlne, 2009) and revised the original model to incorporate the network view of internationalization. They proposed that *insidership* in relevant network(s) is necessary for successful internationalization, and that relationships offer the potential for learning and for building trust and commitment, both of which are preconditions for internationalization. Johanson and Vahlne (2009) further emphasized that such learning develops within relationships between partners (e.g., suppliers and customers) that are located in different countries. This is especially visible in international new ventures, where the founders often have prior knowledge and contacts with potential customers located in different geographies. In new ventures that experience accelerated internationalization, such as born global firms, the entrepreneurs' networks, and prior knowledge of international markets, including meeting new customer demands, are understood to influence the commitment level of the entry mode selected (Shrader, Ovaitt & McDougall, 2000). The continuing internationalization by born globals, which Melén and Nordman (2009) categorized as low, incremental, and high commitment, can thus be viewed as contingent on the development of knowledge regarding customer needs and preferences. Kim et al. (2011) studied how born globals' customer (market) orientation leads to innovativeness through technological capability associated with customer relationship management and marketing orientation. While studies (e.g., Freeman, Deligonul & Cavusgil, 2013; Yu, Gilbert & Oviatt, 2011) have indicated that acceptance of a firm by foreign customers is essential for successful internationalization, there is a gap in the literature, in terms of understanding product-related factors in context of the knowledge-based perspective on the internationalization process. The Indian apparel industry, which is one of the country's most globalized industries, offers an interesting context to study, in order to address this gap.

The chapter is based on data collected through questionnaires and interviews with born globals in the Indian textile industry, aimed at understanding the internationalization modes adopted by these firms. Our results should provide insights into the internationalization processes of born globals from other emerging economies with business conditions that are comparable to those in India. In addition, there are other sectors in India, such as computer software, jewelery, and leather, which also have substantial numbers of born globals.

The chapter begins with a theoretical framework, followed by discussions of results of previous research, the research methodology, and the case data study and analysis, and ends with concluding remarks, a discussion of the limitations, and suggestions for future research.

Theoretical Framework

Johanson and Vahlne (1977) proposed that the internationalization process of a company depends on its gradual acquisition of foreign market knowledge, and that this can be accomplished by increasing involvement of the firm in foreign markets via extension of its operations in these markets. The same authors revisited the model (Johanson & Vahlne, 1977), and suggested that the current business environment is to be viewed as a web of relationships, and that outsidership, in relation to a particular network, is a root of uncertainty, on the basis that new knowledge is developed in the context of relationships. Therefore, in this new vision of internationalization, *insidership* in relevant networks is an essential criterion for successful internationalization.

The international entrepreneurship literature (e.g., Johanson & Vahlne, 2009; Melén & Nordman, 2009) suggests that born globals are flexible in the internationalization modes that they use, and readily adapting the modes to the needs of individual market and clients. This flexibility is probably especially important for born globals from emerging markets. Persinger, Civi, and Vostina (2007) addressed the born global entrepreneur within the context of an emerging market, and proposed that entrepreneurs with high need for achievement in the global arena are likely to start globally oriented firms. Further, they argued that entrepreneurs with a strong global orientation are more likely to be founders of a born global firm, and concluded that born global entrepreneurs from emerging economies must possess the necessary characteristics to become successful in the turbulent and risky business environment of emerging economies.

Rialp, Rialp, and Knight (2005) studied the phenomenon of early internationalization and suggested that some important factors leading to early internationalization include, among others, managerial global vision from inception; a high degree of previous international experience among managers; and a niche-focused, proactive international strategy in geographically spread lead markets around the world, from the very beginning of the firm's existence. Thus, an entrepreneurial mind-set is necessary to establish a born global and then to expand using various internationalizing modes.

Integrating these two perspectives, Melén and Nordman (2009) presented a theoretical model dividing born globals into three groups: low committers, incremental committers, and high committers. Low committers rely on low-commitment internationalization modes, such as exporting, to begin and then continue their internationalization processes. Incremental committers begin their internationalization using low-commitment modes, but increase their commitment, at least in some markets, as their internationalization continues. High committers begin internationalization using a variety of internationalization modes, with different levels of commitment, and are flexible during their continued internationalization. See Melén and Nordman (2009) for a graphical representation.

A firm's choice, with respect to high, incremental, or low-commitment modes is also related to its ego network: direct ties, indirect ties, and structural holes (Ahuja, 2000; Burt, 2000, 2004). While direct ties may be more beneficial, indirect ties help with extending the reach of the focal player in the network, thus improving access to information. The choice of a particular internationalization mode will be influenced by the context of the network in which a firm operates. A born global's international market entry mode choice is shaped by its formal and informal network relationships (e.g., Coviello & Munro, 1997). Xiao and Tsui (2007), studying the effect of structural holes in organizations with high- and low-commitment cultures, found that in high-commitment cultures, which emphasize mutual investment among people, organizations are characterized by a great deal of trust, with strong norms of cooperation between employer and employees. Born global firms, which tend to be entrepreneurial and close-knit, arguably have a strong need to replicate this culture in their foreign offices, in order to operate efficiently. In the absence of this ability, such organizations may prefer to rely on their networks, consisting of direct and indirect ties, to create an expanded network and then employ a low-commitment strategy for internationalization. This strategy is especially well-suited for born globals in the textile industry born globals, as the dynamics of product life-cycle force these firms to rely heavily on their networks for guidance pertaining to products and markets.

The key product development challenges in the textile industry (May-Plumlee & Little, 1998) revolve around improving cost effectiveness, shortening the product development life-cycle, and improving market receptiveness of new products. The important performance measures for apparel products are the customer acceptance measures of sales (Sell-through—how the product is selling on the retail floor, Longevity—whether a product has a longer life-cycle extending across many sales seasons or not, and Growth—how much increase in sales the product has experienced) and the financial measure of retail profitability (Jang, Dickerson & Hawley, 2005). In this industry, the product portfolio complexity benefits are often outweighed by increasing costs (Fernhaber & Patel, 2012), which has an effect on the choices facing apparel manufacturers, especially their willingness to create an extensive product portfolio for seasonal and short life-cycle products. Lee and Makhija (2009) studied how two internationalization approaches (international investments through foreign direct investment, and export-related investment, such as investing in export-related infrastructure to respond to demands in international markets) help companies to adapt quickly to such rapid and important changes in their environment. The complexity of the product life-cycle needs to be taken into account when deciding on what internationalization methods to adopt, especially in the apparel industry.

Research Methodology

This study is qualitative in nature, focusing on companies that fit the most common definitions of born globals from the literature (e.g., Knight & Cavusgil, 2004; Melén & Nordman, 2009). The CMIE Prowess database was used to identify companies fitting the criteria of being less than 20 years old, with at least 25 % of revenue from international operations, and internationalized within the first three years after startup, from the textile industry in India, which was chosen as it had more firms that could be defined as born globals (Knight & Cavusgil, 2004). The apparel industry also lent itself to a thorough analysis of the product life-cycle's influence on internationalization modes, especially given the strong seasonality of the product, along with the long ideation-to-productization cycle, relative to the product selling period. The database was supplemented by the researchers' own industry contacts for identifying born globals. A total of eight firms responded to the survey, through e-mail and/or interviews. Seven of these firms were younger than 20 years. One of the firms was dropped from the study as it had been operating for too many years. All of the participating firms confirmed that they had obtained at least 25 % of their revenues from foreign customers within three years of beginning their operations. In fact, all of them had almost their complete revenue coming from foreign customers and markets, right from the beginning.

Cross-Case Study and Analysis

Cross-case methodology allows for systematic studying of multiple cases, to allow for a more intensive examination of issues and the exploration of a wider range of issues across a number of cases (Lee & Chavis, 2012). Cross-case analysis also allows for comparisons of commonalities and contrasts across the various firms (Khan & VanWynsberghe, 2008). Further, the use of multiple data sources enhances the ability to reveal converging and diverging patterns, to increase confidence in interpretation, and to tell the story of how and why change transpired (Lee & Chavis, 2012). Case studies typically combine data collection methods such as archives, interviews, questionnaires, and observations to yield evidence that analyzed may be qualitative (e.g., words), quantitative (e.g., numbers), or both (Eisenhardt, 1989).

The cross-case analysis methodology was used to study the seven case studies of born global firms in the Indian apparel industry's criteria. The three categories of low, intermediate, and high committers, as described by Melén and Nordman (2009), were used to group the cases for the cross-case analysis.

Data Collection

The data collection was based on a questionnaire guided by Melén and Nordman (2009), which was created to assist in categorizing the respondents based on three categories of internationalization. The firms identified were sent e-mails containing the questionnaire. Further, industry contacts and insiders were contacted to help in the collection of data through interviews and/or completing the survey form electronically. Some identified respondents were also contacted by telephone to collect the data. One of the identified firms was visited in an effort to collect the data. Approximately 40 firms were identified from the CMIE database as being appropriate for data collection, and e-mails were sent to 24 of them for which e-mail addresses were available in the database. Further, industry contacts in the southern part of India (Chennai, Tirupur, Karur, Coimbatore, Bangalore, etc.) were contacted and asked to assist with the data collection. Eventually, data were collected from eight firms, of which seven were selected for analysis. Some of the firms were recontacted, to seek clarification and affirm the understanding.

The Case Companies

Descriptions of the internationalization efforts of the seven case companies are given in the following paragraphs. Analysis of the approaches to international markets suggests many commonalities across the firms, and also suggests a subtle divergence in the approach to future strategies. The profile of the firms is given in Table 9.1.

Company A exports cotton-fabric home textiles, and has been obtaining its revenue from foreign markets right from inception. The company deals primarily with the USA and France. The initial contact with an international customer is usually made by the final buyers' Indian agent. E-mail and telephone are the preferred modes for placing orders. The firm is not known to the end-user customer. The main difficulty encountered in developing foreign customer knowledge is in knowing about the tastes and design pattern preferences of foreign customers. The main obstacle encountered during the company's internationalization efforts has been price. No help is sought by Company A from anyone in foreign markets (e.g., agents), with respect to selling its products. The key motivations for internationalization are to increase profitability and the customer base. The firm maintains contact with its customers through bilateral office visits. The buyers provide their own designs and patterns, which Company A manufactures as per the requirements.

Table 9.1 The sample firms

Company	Business area	Founded	Number of interviews/e-mail response	Foreign market entries since foundation (regions of the world)
A	Cotton home textiles	1995	1	USA, France
B	T-shirts, knitwear, hosiery products	2006	2	Europe
C	Garments for men and children	2008	1	Denmark, Spain, France, Italy, Netherlands
D	High-fashion children's products	1995	2	France
E	Cotton yarn suitable for knitting and weaving	1995	1	Brazil, USA, Canada, Portugal, Turkey, Bangladesh, China, Sri Lanka, Egypt
F	Apparel for men	2000	1	USA, Italy, France, EU countries
G	Shirts and garments	1999	1	Americas and Europe

Company B manufactures tee shirts, knitwear, and hosiery products. It exports primarily to Europe, through the purchasing offices of the final buyer, and ships directly to customers. The orders are taken through e-mail and telephone. The firm considers the retailers in Europe to be the end customer, and Company B and the retailers are known to each other. Although some direct exporting takes place, the firm does not exert effort on direct exports and marketing, citing a lack of trust and the economic downturn in Europe. Moreover, Company B prefers to go through purchasing offices with "known faces". Customers are obtained through purchasing agents. Most of the buyers have buying offices and Company B establishes contacts with these offices. As the firm builds to specification, customer preferences are clear, as the buyers have done the necessary research prior to the start of manufacturing. Some of the obstacles that Company B faces in dealing with internationalization are related to competition, the reliability of purchasers, and supplier relationships.

The company mentioned that technical details such as fabric quality and the lack of complete technical specifications are handled on the basis of trust, based on the foreign buyer's specification. Discrepancies in understanding result in producing mismatched goods, leading to payment issues and cancelation by foreign buyers at the last minute, citing issues of quality and timeliness, and resulting in their relocation to Bangladesh or other nations. Even genuine buyers return goods, citing lack of sales, which is very problematic for the firm. Company B maintains contact with purchasing agents and ensures quality, value for money, and timeliness, and working to maintain truly meaningful relationships.

Company C mainly deals with garments for men and children, such as tee shirts and pajamas. They received their first order through a fair in Paris. A family member is based in Europe, and speaks local languages, such as French and Spanish, allowing him to meet and sign up customers. The company takes its orders through e-mail. Since its customers are knowledgeable in the complete end-to-end process, it is not necessary for Company C to educate them. This makes it easier to develop a customer base, focusing mainly on the product and commercial details. The main challenge to the firm's internationalization efforts is competition. Increasing profitability and the customer base is the main aim in the firm's internationalization process, and management hopes to introduce the company's own brand sometime in the future. It also considers foreign customers to be more genuine, in terms of payment and acceptance of the final product. Currently, Company C hires designers in its target markets, to make sure that it produces clothing that is in line with current tastes and trends. As Company C designs its own products through designers, samples are used in discussions with buyers and representatives. As the business is expanding, Company C plans to hire local representatives in Europe in a year or two.

Company D produces high-fashion children's products, dealing mainly with major stores in Europe. The firm establishes its initial contact with global customers through fairs, websites, and its liaison office in India. The orders are taken via e-mail, telephone, and directly through local representatives. Company D makes products as per the buyer's requirements; hence, customers do not require any training on usage of the products. The major effort toward smooth internationalization is based on maintaining and improving quality to ensure customer satisfaction. The company also has a major focus on producing garments as per current and future fashion. Growing the organization by increasing the customer base is a major reason for Company D's internationalization efforts. Also, regulations, locally and in foreign markets, encourage internationalization efforts. Regular follow-up and communication with customers is undertaken, and fairs and exhibitions are used to gain knowledge of foreign markets and trends. Company D is planning to increase its resource commitment to internationalization, due to encouraging feedback from buyers.

Company E produces cotton suitable for knitting and weaving. Its international market extends to countries across the Americas, Asia, Europe, and Australia. The initial customer contact is made through agents and at international exhibitions and seminars. The ordering is done through e-mail, telephone, distributors, and representatives. As the international business is conducted through agents and distributors, Company E is not known to the end users. Therefore, acquiring knowledge about the end users' product quality requirements is a challenge. Highly volatile currency value fluctuation and the credit worthiness of customers and their bankers pose obstacles in the firm's internationalization efforts. Company E relies on its agents to obtain repeat orders throughout the year, along with the sourcing of new customers at regular intervals. As part of its future internationalization efforts, Company E wants to develop direct relationships with end users, and to produce the final products to meet the customers' specific requirements. The firm's key rationales for internationalization include increasing the customer base, generating higher profitability, and growing the organization. The absence of a local market for its product also encourages the seeking of international markets. Company E gains foreign market knowledge through industry contacts, agents, and global market watch through active Internet-based research, and uses follow-up for repeat orders as a channel for gauging customer satisfaction levels. While the firm recruits local staff in foreign locations to assist with marketing, all products are made to order, based on specifications stipulated by specific customers.

Company F manufactures apparel for men, catering mainly to the US and European markets. They establish their contacts with international customers through face-to-face meetings and presentations that include the sharing of samples. The orders are taken primarily over e-mail, and samples are verified prior to bulk production. A key challenge that the company encounters in developing knowledge about foreign customers is in identifying the market and its needs. Constant innovation is required to stay competitive and relevant, especially in the garment industry, due to constantly changing tastes, trends, and fashion; this pertains to a range of aspects, including color, embellishments, fabric, and production. The major obstacles associated with internationalization efforts come in terms of costing and pricing, especially due to competition from countries such as Sri Lanka, Cambodia, Pakistan, and Bangladesh. In addition, customer parameters pertaining to quality, including the use of non-toxic materials, are very strict. Company F works with importers in foreign countries, such as wholesale distributors, to sell its products. Its approach to internationalization is to integrate vertically and become a one-stop shop for its international customers, catering to all needs, including fabric, design, accessories, and garments, with everything done in-house. Increasing the customer base and profitability are the main drivers for Company F's internationalization efforts. It keeps in touch with its customers by constantly traveling overseas, making presentations, and updating customers with new developments. The firm gains knowledge about markets and trends by attending fairs, fashion exhibitions, and shows. Company F has consistently increased the resource commitment made to its internationalization efforts, by assuming that about 25 % of its customers will churn every year and that the firm needs to find new customers to compensate for those customer losses and increase turnover; the firm's managers clearly feel the need to plan and invest, constantly, to support the firm's growth goals.

Company G mainly operates in the USA and Europe, dealing with shirts and garments. The orders are taken mainly through e-mail and the firm is not known to end users. Identifying markets and their needs, in terms of requirements and trends, represents a major difficulty with respect to developing knowledge about foreign customers. Company G finds that attending fairs and talking to distributors help it to gain foreign market knowledge and details regarding trends. The major challenges to the firm's internationalization pertain to costs and competition from firms in other countries, along with maintaining quality according to customer expectations. Company G works with distributors and importers in other markets to sell its products. The firm's primary motivations for seeking international markets are increasing its customer base and improving profitability.

Low Committers

Low committers are firms that begin their internationalization using low-commitment modes (e.g., exporting), and continue to do so. Analysis of the seven cases suggests that all of these firms can be characterized as low committers, which may be typical born globals in the apparel and textile industry in India.

Company A's low-commitment approach to internationalization is demonstrated by its focus on increasing profitability through relying on agents, and reducing risk in the absence of market information by utilizing the agents and their customer bases. The firm relies on indirect ties to increase its reach, and to compensate for the structural holes in its ability to connect with the end customer by working with agents, who perform a brokering function. Further, the product life-cycle dynamics are handled by taking designs and patterns from the buyers themselves, thus filling the information void in their product market knowledge.

Company B, a relatively new entrant, seems to prefer a low-commitment internationalization strategy due to trust issues, derived from returns of goods to the company and the shifting of production to other low-cost production locations. To deal with these challenges, the firm uses purchasing agents to improve its ability to reach to the end customers. At the same time, the purchasing agents, who play a brokering role, are able to fill the gaps in Company B's network by providing access to reliable buyers and helping to reduce the incidence of opportunism (Hill, 1990; Crook, Combs, Ketchen Jr. & Aguinis, 2013; Weber & Mayer, 2014).

Company C, also a recent entrant, designs its own garments and approaches buyers directly. The company relies on direct ties to market its products and uses foreign market-based designers to create new offerings. The firm's current low-commitment strategy is driven by its focus on increasing both profitability and the size of its customer base.

To improve its ability to reach customers, the firm plans to hire representatives, which would enable it to continue its low-commitment strategy through the use of indirect ties. The gap in Company C's organizational capability with respect to understanding end-user product preferences is bridged by the designers. Company C wants to distribute its own brand, and is thinking of increasing its commitment level by hiring more direct representatives in foreign markets (Gaur & Kumar, 2010; Kumar, Gaur & Pattnaik, 2012).

Company D, a seasoned firm, has a strong network of direct ties with merchandising managers and producing in accordance with customer requirements. The firm's low-commitment strategy is driven by its strong relationship with buyers, and its focus is on increasing its customer base and using fairs to increase its direct ties.

Company E operates over a particularly large geographic area, and relies on its indirect ties with agents to reach the end customer. The need to increase the customer base drives the firm's reliance on agents; these indirect ties enhance Company E's access to relevant information regarding customers and products. The low-commitment international strategy has worked for the firm, and has helped it to concentrate on increasing profitability and its customer base (Knight & Cavugil, 2004; Zhou, Wu & Lou, 2007; Hashai, 2011).

Company F uses direct ties with end buyers, and designs its own products (Yu, Gilbert & Oviatt, 2011; Jones & Coviello, 2005; Hashai & Almor, 2004). This firm's commitment level of internationalization, while still categorized as low, is relatively higher, due its emphasis on direct ties and increasing the customer base. It makes up for gaps in its network by undertaking frequent travel to meet customers and attend trade events and shows. The relatively higher commitment strategy is also reflected in its investment to create samples, in order to engage customers directly, and in its constant attempts to acquire new customers in order to make up for lost ones.

Company G produces customers' designs and follows a low-commitment internationalization strategy. It uses indirect ties in foreign markets, in the form of distributors and importers, to widen its network. The indirect ties are further expanded by attending trade fairs. This suits the company's focus on profitability and on increasing its customer base.

From the analysis of the various cases, it emerges that these firms are using low-commitment internationalization strategies that rely on indirect ties, to focus on increasing their customer bases and their profitability. Engaging with purchasing agents and distributors in foreign markets, who act as brokering agents, also helps the firms in securing repeat business, effectively independent of the end customer.

The case firms' internationalization modes are summarized in Table 9.2.

Discussion

Our analysis of born globals in the Indian apparel industry indicates that these organizations aim to be global players although they employ low-commitment strategies for their continued internationalization. The most commonly stated reasons for internationalization are to increase profitability and the customer base. The main challenge in these firms' international efforts comes from cost and price points, in addition to the

Table 9.2 The sample firms' main international modes

International sales/marketing methods used/ being used				
Company	Direct export since	Exports via independent representatives, distributors, agents, strategic alliances, joint ventures since	Establishment of local sales subsidiaries in foreign market(s) since	Establishment of local manufacturing subsidiaries in foreign market(s) since
A	1999	1998	1995 (in India)	No
B	2006	2006	No	No
C	2008	2008	2009; just an address office in Europe	No
D	1995	Using liaison office of buyers based in India	No	No
E	1997	1997	No	No
F	2000	2000	Have brand in Italy, hence office is Europe	No
G	1999	1999	No	No

competition from firms in other producer nations. Maintenance of quality is an area of strong focus for all seven of the born globals, as part of their continuing internationalization efforts. The firms are comfortable operating with purchasing representatives, and use meetings, along with presentations showing samples, to make their sales pitches to various buyers, including potential distributors. A key goal of some of the born global firms in the study is to launch their own brands as part of their continued internationalization, rather than establishing manufacturing units outside of India. This is aimed at increasing margins, as the born globals in the Indian apparel industry are under pressure, due to raising operational costs and competition from other, lower cost, producer countries. The 2005 changes in Multi-Fiber Agreement (Watchravesringkan, Karpova, Hodges & Copeland, 2010), in which the World Trade Organization members committed themselves to removing country-based textile quotas by January 1, 2005, to integrate the textile sector fully into the General Agreement on Tariffs and Trade rule, acted as a game changer for many earlier born globals, with respect to maintaining their market shares and remaining competitive. While all of these challenges remain, the firms in the study are making increasing investments toward their internationalization efforts, reflecting the managers' entrepreneurial natures. The ability to "think big", in terms of wanting to create their own brands, is indicative of the ability of these organizations to develop creative ways to thrive and prosper in competitive conditions. At the same time, it is interesting to consider why all seven of these born globals display a "low committers" approach to internationalization. One possible explanation can be found in the product development cycle and new product development dynamics of the apparel industry.

As May-Plumlee and Little (1998) indicated, apparel manufacturing firms need to focus on improved market responsiveness in a demand-activated, customer-driven, and competitive retail business environment. The apparel product development process forces the firms to concentrate on improving the cost effectiveness of their processes by streamlining and shortening the product development cycle, and improving market receptiveness through the addition of custom-fit products, while developing new products close to the selling season. These Indian apparel-industry born globals depend heavily on fairs and exhibitions, and inputs from distributors and representatives, to understand customer preferences.

Further, apparel-industry products are developed in seasonal lines, rather than as individual products, and the product life-cycle is relatively short (Jang, Dickerson & Hawley, 2005). Typically the cycle from product research and design to the final customer purchase takes one year. At the same time, several lines of new products must be produced annually. As a result, while one product line is being developed, the previous line may be in production, and a third line may be selling at retail sales. As the products are largely seasonal, the merchandising calendar is used to schedule processes. This leads to a situation in which the sales data for the previous season's line are incomplete, and so decisions must be made on new products without benefit of data regarding consumer acceptance of the previous year's products. There are also further system constraints, such as vendor reliability, raw material availability, and achieving the target price point (May-Plumlee & Little, 1998).

The inherent uncertainties of economic conditions, the need to constantly understand consumer preferences, and the quick turnaround times required are the key reasons behind the Indian apparel-industry born globals' continued use of low-commitment strategies in approaching international markets. The managers' shared view is that their investments are better spent in trying to increase the customer base and raise profitability, by engaging distributors and in preparing sales samples as per the recommendation of the end customers.

There is strong evidence that organizational apparel buyers place emphasis on price, quality, flexibility, and responsiveness when assessing vendors (Thaver & Wilcock, 2006). As on-time delivery and achieving quality standards are key to success in the apparel business, these Indian-born globals concentrate on these criteria, aiming to increase their international business. Launching their own brands would require them to invest more in understanding international customers, and their seasonal preferences, by having direct contact with the end users. This may entail hiring designers and market research professionals in the foreign markets, and not relying solely on distributors and local buyers. Because customer acceptance measures are most important for gauging the success of apparel products (Jang, Dickerson & Hawley, 2005), at this stage, the Indian-born global apparel firms seem to be comfortable following the low-committer strategies of operating through distributors, and buyers/importers from large stores and foreign brands.

In this study, we have investigated Indian-born global firms in the apparel industry, and attempted to explain their consistent use of low-commitment internationalization strategies based on the dynamic nature of product development in this industry. This study has been based on responses from firms based mostly in South India. It would be worthwhile for future research to see if the findings are consistent in other parts of India, as well as in other emerging economies. Future work might also study the product development challenges of Indian-born globals in the apparel industry, along with the steps the apparel born globals need to take toward internationalization in terms of their ambitions to introduce their own brands in foreign markets. Our study highlights the challenges faced by emerging-market born globals in their internationalization efforts, and emphasizes the need for ongoing research in this area.

References

Ahuja, G. (2000). Collaboration networks, structural holes, and innovation: A longitudinal study. *Administrative Science Quarterly, 45*(3), 425–455.

Burt, R. S. (2000). The network structure of social capital. *Research in Organizational Behavior, 22*, 345–423.

Burt, R. S. (2004). Structural holes and good ideas. *American Journal of Sociology, 110*(2), 349–399.

Coviello, N., & Munro, H. (1997). Network relationships and the internationalisation process of small software firms. *International Business Review, 6*(4), 361–386.

Crook, T. R., Combs, J. G., Ketchen, D. J., Jr., & Aguinis, H. (2013). Organizing around transaction costs: What have we learned and where do we go from here? *Academy of Management Perspectives, 27*(1), 63–79.

Eisenhardt, K. M. (1989). Building theories from case study research. *Academy of Management Review, 14*(4), 532–550.

Elango, B., & Pattnaik, C. (2007). Building capabilities for international operations through networks: A study of Indian firms. *Journal of International Business Studies, 38*(4), 541–555.

Fernhaber, S. A., & Patel, P. C. (2012). How do young firms manage product portfolio complexity? The role of absorptive capacity and ambidexterity. *Strategic Management Journal, 33*(13), 1516–1539.

Freeman, S., Deligonul, S., & Cavusgil, T. (2013). Strategic re-structuring by born-globals using outward and inward-oriented activity. *International Marketing Review, 30*(2), 156–182.

Gaur, A., & Kumar, V. (2010). Internationalization of emerging market firms: A case for theoretical extension. *Advances in International Management, 23*, 603–627.

Hashai, N. (2011). Sequencing the expansion of geographic scope and foreign operations by "born global" firms. *Journal of International Business Studies, 42*(8), 995–1015.

Hashai, N., & Almor, T. (2004). Gradually internationalizing "born global" firms: An oxymoron? *International Business Review, 13*(4), 465–483.

Hill, C. W. L. (1990). Cooperation, opportunism, and the invisible hand: Implications for transaction cost theory. *Academy of Management Review, 15*(3), 500–513.

Jang, N., Dickerson, K. G., & Hawley, J. M. (2005). Apparel product development: Measures of apparel product success and failure. *Journal of Fashion Marketing and Management, 9*(2), 195–206.

Johanson, J., & Vahlne, J.-E. (1977). The internationalization process of the firm - a model of knowledge development and increasing foreign market commitments. *Journal of International Business Studies, 8*(1), 23–32.

Johanson, J., & Vahlne, J.-E. (2009). The Uppsala internationalization process model revisited: From liability of foreignness to liability of outsidership. *Journal of International Business Studies, 40*(9), 1411–1431.

Jones, M. V., & Coviello, N. E. (2005). Internationalisation: Conceptualising an entrepreneurial process of behaviour in time. *Journal of International Business Studies, 36*(3), 284–303.

Khan, S., & VanWynsberghe, R. (2008). Cultivating the under-mined: Cross-case analysis as knowledge mobilization. *Qualitative Social Research, 9*(1), 1–21.

Kim, D., Basu, C., Naidu, G. M., & Cavusgil, E. (2011). The innovativeness of born-globals and customer orientation: Learning from Indian born-globals. *Journal of Business Research, 64*(8), 879–886.

Knight, G. A., & Cavusgil, S. T. (2004). Innovation, organizational capabilities, and the born-global firm. *Journal of International Business Studies, 35*(2), 124–141.

Knight, G. A., Madsen, T. K., & Servais, P. (2004). An inquiry into born-global firms in Europe and the USA. *International Marketing Review, 21*(6), 645–665.

Kumar, V., Gaur, A., & Pattnaik, C. (2012). Product diversification and international expansion of business groups. *Management International Review, 52*(2), 175–192.

Lee, K. S., & Chavis, D. M. (2012). Cross-case methodology: Bringing rigour to community and systems change research and evaluation. *Journal of Community and Applied Social Psychology, 22*, 428–438.

Lee, S.-H., & Makhija, M. (2009). Flexibility in internationalization: Is it valuable during an economic crisis? *Strategic Management Journal, 30*(5), 537–555.

May-Plumlee, T., & Little, T. J. (1998). No-interval coherently phased product development model for apparel. *International Journal of Clothing Science and Technology, 10*(5), 342–364.

Melén, S., & Nordman, E. R. (2009). The internationalization modes of born globals: A longitudinal study. *European Management Journal, 27*(4), 243–254.

Oviatt, B. M., & McDougall, P. P. (1994). Toward a theory of international new ventures. *Journal of International Business Studies, 25*(1), 45–64.

Oviatt, B. M., & McDougall, P. P. (1997). Challenges for internationalization process theory: The case of international new ventures. *Management International Review, 37*(2), 85–99.

Persinger, E. S., Civi, E., & Vostina, S. W. (2007). The born global entrepreneur in emerging economies. *International Business and Economics Research Journal, 6*(3), 73–82.

Rialp, A., Rialp, J., & Knight, G. A. (2005). The phenomenon of early internationalizing firms: What do we know after a decade (1993–2003) of scientific inquiry? *International Business Review, 14*(2), 147–166.

Shrader, R. C., Oviatt, B. M., & McDougall, P. P. (2000). How new ventures exploit trade-offs among international risk factors: Lessons for the accelerated internationalization of the 21st century. *Academy of Management Journal, 43*(6), 1227–1247.

Thaver, I., & Wilcock, A. (2006). Identification of overseas vendor selection criteria used by Canadian apparel buyers. *Journal of Fashion Marketing and Management, 10*(1), 56–70.

Varma, S. (2011). Born global acquirers from Indian IT: An exploratory case study. *International Journal of Emerging Markets, 6*(4), 351–368.

Watchravesringkan, K. T., Karpova, E., Hodges, N. N., & Copeland, R. (2010). The competitive position of Thailand's apparel industry: Challenges and opportunities for globalization. *Journal of Fashion Marketing and Management, 14*(4), 576–597.

Weber, L., & Mayer, K. (2014). Transaction cost economics and the cognitive perspective: Investigating the sources and governance of interpretive uncertainty. *Academy of Management Review, 39*(3), 344–363.

Xiao, Z., & Tsui, A. S. (2007). When brokers may not work: The cultural contingency of social capital in Chinese high-tech firms. *Administrative Science Quarterly, 52*(1), 1–31.

Yu, J., Gilbert, B. A., & Oviatt, B. M. (2011). Effects of alliances, time, and network cohesion on the initiation of foreign sales by new ventures. *Strategic Management Journal, 32*(4), 424–446.

Zhou, L., Wu, W.-P., & Luo, X. (2007). Internationalization and the performance of born-global SMEs: The mediating role of social networks. *Journal of International Business Studies, 38*(4), 673–690.

10

Innovation and Entrepreneurship in the Informal Economy: Insights from the Ground Zero

Pavan Soni

Employment in the informal economy is frequently related to low-paying jobs, chronic poverty, weak social protection, sweatshop environments, labor exploitation, low productivity, and limited opportunities to move up the economic ladder. The informal economy has for long been understood as a 'problem', and researchers have advocated for various measures to overcome this issue. The International Labor Organization (ILO) impresses upon quality employment and decent jobs to solve the problem of informal economy, whereas the World Bank deems functioning labor markets and institutional reforms as a panacea.

However, it is getting apparent that many people in developing and developed countries voluntarily opt out of the formal setup to be self-employed in the informal economy. A large part of the informal economy today happens on an own-account basis, and has graduated from 'exploitative sweatshops' to a 'hidden enterprise culture'. Though the

P. Soni (✉)
Indian Institute of Management Bangalore, Bengaluru, India
e-mail: pavan.soni@iimb.ernet.in

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_10

interest in studying informal economy has grown in the recent years, and a considerable ground is covered on investigating the entrepreneurs within, not much has been said about their innovations. India, the world's largest informal economy by size, houses more than a few million entrepreneurs and offers a very fertile ground to study the innovations these entrepreneurs bring to thrive in such setups. Innovation in the informal economy becomes all the more important to achieve competitive differentiation, and there do not exist sufficient institutional mechanisms to protect the property rights of the players, and transaction costs are very high owing to non-existence economic intermediaries.

The chapter attempts to investigate the phenomenon of innovation amid the entrepreneurs operating in the informal economy. Situated in an urban setup, in the city of Bangalore, the paper delves into the practices of two highly innovative self-employed street vendors. The intent is to study the motives, strategies, innovations, and philosophies adopted by such entrepreneurs. Based upon in-depth interviews, this working paper proposes four key insights. First, these entrepreneurs started by being necessity-driven, but once they got the taste of doing business, they became opportunity-driven and remained in the informal economy. Second, they developed and adopted simple heuristics to make their pricing and inventory management decisions, considering their negligible educational level and limited apprenticeship avenues. Third, the entrepreneurs exercised market innovations in identifying the right locality and offerings to do business with, and by saturating the carrying capacity of their respective markets, thus managing to keep competitors at bay. Last, artful tactics and innovations were observed in the way these informal entrepreneurs managed their relation with the formal economy, especially with the police and regulators.

The paper has five sections. The first section offers an overview of the existing state of research on the informal economy, including characteristics and schools depicting the phenomenon. The second section delves into research on entrepreneurship in the informal economy and presents the critical debates and insights. The third section builds the case for the need to study entrepreneurship in the informal sector in India, with a focus on understanding innovation practices. The fourth section details the study, and the fifth section shares the interim findings. The profile sketches of the two entrepreneurs considered in the chapter are in the appendix.

The Nature of Informal Economy

For long, economists did not consider the informal economy worthy of studying. It was not until Hart (1973) documented the economic activities in the low-income groups in Ghana that the economists and sociologists took notice of the phenomenon that exists at the margins of the formal economy. In another influential work, Portes, A., Castells, M., and Benton, L.A. (1989) depicted the various informal sectors that exist outside the regulatory ambit. Informal sectors exist in different forms and across developing and developed economies. The ILO defines informal economy as:

> *All economic activities by workers and economic units that are—in law or practice—not covered or insufficiently covered by formal arrangements. Their activities are not included in the law, which means that they are operating outside the formal reach of the law; or they are not covered in practice, which means that—although they are operating within the formal scope of the law, the law is not applied or not enforced; or the law discourages compliance because it is inappropriate, burdensome or imposes excessive costs.* (Trebilcock, 2005: 2)

Researchers have highlighted different dimensions of the informal economy. For instance, De Soto (1993) bases informal economy on the strength of or even complete *absence of property rights*; Swaminathan (1991) characterizes such economies by *lack of regulation and state recognition*, which Trebilcock (2005) argues to be *rooted in poor governance.* Regarding the people engaged in such economies, Williams (2008) identifies them to be mostly working on full or partial *off-the-books manner,* while Maloney (2004) deems them as *voluntary micro-entrepreneurs*, owners of small firms.

There are predominantly five schools of thoughts explaining the phenomenon of informal economy:

– ***Dualist view***: It bases the rise of the informal sector to the population growth and urban migration in emerging economies, and the inability of the formal economy to absorb the surplus of unskilled and uneducated labor (Hart, 1973; Trebilcock, 2005). According to this school, as economies develop, their formal economy would absorb all of the informal activities.

- ***Structuralist view***: It proposes that the informal economy exists to support the formal economy by offering low-cost, specialized jobs, and hence they both are tied in a capitalistic system. Most of the informal sector hence supports the formal sector through subcontracting, providing flexible labor, and specialized skills (Piore and Sabel 1984).
- ***Legalistic view***: This view argues that informal economy stems from excessive complexity and cost associated with registration of formal economic activities, and high taxation on small entrepreneurs (De Soto, 1993). Here people chose to voluntarily exit formal economy, and thereby signal a widespread resistance to overregulation (Williams & Nadin, 2010; Maloney, 2004).
- ***Post-structural view***: It highlights the entrepreneurship pursued social and redistributive reasons, rather than purely financial gains (Williams & Nadin, 2010).
- ***Colonial view***: Under this approach, the informal economy is maintained by the restrictions imposed by the settled-colonial domination, such that the dominated state is cut-off from the formal mainstream economy for the immediate gains of settlers, as in the case of Israeli settlement in Palestine (Awwad, 2012).

Against the belief of the *dualist* theorists that the informal economy will slowly disappear as economies world over develop, informal economies are anything but shirking in developing and developed countries (Swaminathan, 1991; Cross, 2000). This increase in the share of informal activities can be attributed to a shift of many formal sectors to informal ones, recessionary pressures on the formal economy, an absolute increase in the volume of informal activities, and changing demographic dividend (Jütting, Parlevliet, & Xenogiani, 2008).

While estimating the size of the informal economy, ILO classifies the people engaged in the informal sector into two categories: *those employed in the informal sector* and actual *informal employment*, where jobs in the informal sector and informal employment refer to different aspects of informality. Accordingly:

> *Employment in the informal economy is an enterprise-based concept and covers persons working in units that have 'informal' characteristics about, e.g., the legal status, registration, size, the registration of the employees, their bookkeeping*

> *practices, etc. Informal employment is a job-based concept and encompasses those persons whose principal jobs lack basic social or legal protections or employment benefits and may be found in the formal sector, informal sector or households. Almost all individuals employed in the informal sector are in casual employment. However, not all those in informal employment belong to the informal sector: there may be people working outside of the informal sector (i.e., either in the formal sector or households producing for own final use) that have casual employment.* (ILO, 2012)

Based on the study of 47 medium- and low-income countries, the report highlights that in all except two countries, the number of persons employed in the informal sector exceeds that in informal employment outside the informal sector, suggesting that the bulk of casual work is concentrated in jobs in the informal sector (ILO, 2012). In India, there were 185 million persons with casual employment in 2010–2011, representing 83.6 percent of the non-agriculture employment. Of this, 35 million were females, and 150 million were males; and the 83.6 percent of informal employment primarily constituted of persons employed in the informal sector (68.8 percent). China, on the other hand, had only 32.6 percent of its workforce engaged in informal employment.

Further, one must appreciate that formality and informality in an economy exist more as a continuum rather than as binary states (Trebilcock, 2005). In a survey of the participation of workers in the formal and informal economy in *Bangladesh*, *China*, *Ethiopia,* and Indian state of *Gujarat*, the finding was that Gujarat had the highest share of people working in completely informal setup or mix of formal and informal, as compared to any other context (Jütting et al., 2008). India appears as not only the world's largest informal economy but also home to a significant number of entrepreneurs operating in this space. We now move to one of the interesting phenomena in the informal sector—*entrepreneurship*.

Entrepreneurship in the Informal Economy

Swaminathan (1991) deems that three forms of employment exist in the informal sector: *self-employment*, *family labor*, and *hired labor*, where the hired labor could further be of a casual or stable type. In a more encompassing definition, the ILO classifies employment in the informal sector into four segments: *wages and salaried workers*, *employers or entrepreneurs*, *own-account workers*, and *contributing family workers* (Jütting et al., 2008). In another report, Williams and Nadin (2010) offer a distinction between entrepreneurs trading in the informal economy versus those participating in the criminal economy that engages drug-dealers, human traffickers, kidnappers, and extortionists, among others. Clearly, the interest of this study is in observing the activities of *self-employed* or *owner–manager–entrepreneurs operating legal businesses*, albeit unregulated.

For the purpose of this chapter, we adopt the definition of entrepreneurs in the informal economy offered by Williams and Nadin as:

> *those engaged in the paid production and sales of goods and services that are legitimate in all respects besides the fact that they are unregistered by, or hidden from the state for tax and benefits purposes*. (2010: 363)

The informal sector offers a fascinating setting to study entrepreneurship. Identifying the entrepreneurial potential provided by the informal economy, the ILO states that such an economy provides opportunities for workers to display real business acumen, creativity, dynamism, and innovation (Trebilcock, 2005). Gerxhani (2004) justifies the choice of entrepreneurs to operate in the informal sector stating that such a setup offers them more autonomy, flexibility, and freedom, and helps exhibit their creativity.

Entrepreneurship in the informal economy can have many sources. Stebbins (1982) identifies informal enterprise in the form of people pursuing *serious leisure*, which can take the shape of amateurism, hobbyist pursuit, or career volunteering. In a study of self-employed workers of New York City's East Village neighborhood, Snyder (2003) explicates three routes to the informal sector: *constricted opportunity in the formal sector*, *individual economic motivations*, and *individual identity motivations*. Informal setups could also be *spin-offs from formal employment* (Williams, 2008; Maloney, 2004). Entrepreneurial activities in the informal economy are studied from multiple perspectives. Some of the perspectives are given below.

State of Country's Economic Development

A state's economic development affects the employment opportunities available for labor to participate in, and it is shaped further by the strength of its institutions. One of the critical determinants of entrepreneurial activities is the availability of funds and labor. With underdeveloped or inefficient intermediaries in the underdeveloped economies, formal entrepreneurial activities are rendered costly (Krishnan, 2010). Hence, entrepreneurs in underdeveloped or developing economies resort to informal means of gathering funds, labor, and market access (Maloney, 2004).

In a study of entrepreneurial activities in *Russia*, *Ukraine*, and *England*, Williams (2008) identified that in these three countries, 100 percent, 90 percent, and 77 percent of entrepreneurs operate in informal economies, respectively. Interestingly, even in developed countries, such as England, one in five entrepreneurs operates on an entirely informal basis, with other entrepreneurs having varying levels of regulatory control. The study also shows that a significant portion of informal entrepreneurs is clustered around the lowest and the highest income quartiles, contrary to the view that informal economy mostly engages people from lower income groups.

Gender-Based Participation in Informal Entrepreneurial Activities

Gender has a very significant influence on the opportunities and situations that lead to involvement in the informal economy. Women are overrepresented in the informal sector as they have fewer avenues available for the formal setup (Maloney, 2004). Marital status has a huge bearing on participation in the formal economy. Further, women with young children are more likely to be engaged in entrepreneurial activities in informal setup than single ones (Jütting et al., 2008).

Williams and Gurtoo (2011) identify the critical insights that current research on the participation of women in the informal economy offers. First, female entrepreneurs in informal economy *operate at a very low level of organization and scale* and have little or no access to institutional credit. Second, they *lack formal space for operations* and have to protect themselves from harassment by local authorities, apart from facing severe occupational hazards associated with improper working conditions. Third, their work often *does not constitute a separate legal entity*, independent of the household, even though most transactions are market-based. Lastly, they are subjected to *severe mobility constraint* owing to other household responsibilities.

Perpetuity in the Informal Economy or Graduation to Formal Economy

Entrepreneurs may participate in the informal sector as a stepping stone to get enrolled into the formal economy, and many others may continue with the informal setup (Williams & Nadin, 2010). In a study of workers in the informal sectors in Latin America, Maloney (2004) identifies voluntary micro-entrepreneurship activities where such entrepreneurs preferred informal sector over the formal sectors and did not treat it as a stepping stone. For instance, in Mexico, over 60 percent of entrepreneurs in the informal sector left their previous jobs and entered the industry voluntarily. Such entrepreneurs devise informal mechanisms anchored in their social networks and immediate neighborhood for managing risks.

Further, entrepreneurs chose to operate in areas where they could maximize their utilities and have a comparative advantage over others or against participating in the formal sector (Jütting et al., 2008). Hence, the dualist perspective, which advocates that people would treat the informal economy as a stepping stone to participate in the formal economy, has not met with strong empirical support, especially in rapidly developing economies.

Opportunity-Driven or Necessity-Driven Entrepreneurship

In a global study of entrepreneurial activities, Bosma and Levie (2010) classify entrepreneurship based on individual as *opportunity-driven* or *necessity-driven*. The opportunity-driven or 'pushed' enterprise refers to those endeavors born out of choice to exploit a business opportunity while necessity-driven or 'pulled' entrepreneurship involves options where work is either limited or unsatisfactory. This 2009 study of *Global Entrepreneurship Monitor* depicts that the ratio of opportunity-driven to necessity-driven business owners is higher in high-income countries than in middle-income countries (Bosma and Levie, 2010). However, in a study of households engaged in off-the-books basis activities in English localities, Williams (2007) identifies that the ratio of opportunity-driven to necessity-driven business owners is no different from that observed in formal economic setup or legitimate entrepreneurship. In fact, a large share of entrepreneurs in the informal economy tends to be opportunity-driven rather than being pushed by the circumstances. This finding goes against the 'marginality thesis' which offers that the informal economy 'forces' people to take up self-employment primarily due to lack of opportunities.

Education level and age also have implications on participating in the informal sectors as entrepreneurs or self-employed. Jütting et al. (2008) observe that people with a moderate level of education are more likely to be self-employed in the informal economy than those with none or very high education levels. Similarly, middle-aged and older individuals are more likely to be entrepreneurs in the informal setup, as younger people would have better opportunities in the formal sector or as waged workers.

Entrepreneurship in India's Informal Economy

India houses arguably one of the world's largest informal economies. With over 185 million people employed in various informal jobs outside of the agriculture sector (ILO, 2012), the segment plays a vital role in the country's growth. Amit Mitra, the Secretary General of the Federation of Indian Chambers of Commerce and Industry, attributes India's growth story to its over 45 million entrepreneurs operating in the informal economy (The Economist, 2010). On another account, Dasgupta and Singh (2005) opine that for India to meet its above 6 percent gross domestic product growth trajectory over next few years, more jobs and work have to be found in the informal sector for a large number of people. This infers creation of more employment in the services sector, and generation of greater entrepreneurial opportunities in the informal economy.

The informal economy in India is studied from various perspectives in recent years. In a very early work, Breman (1996) studied the activities in the informal and semi-formal sectors in the state of Gujarat in India, focusing on employment patterns. In a study of self-help groups of women in the micro-credit industry, Hill (2001) highlighted the importance of mutual recognition in activating worker identity, and work–life balance in achieving economic development. Carr and Chen (2001) depicted the impact globalization has on workers in the informal economy of India. Harris-White and Sinha (2007) studied the effects of trade liberalization on employment in the informal sector in India and the resulting social disparity, taking the instance of garments and rice processing industries. More recently, Athique (2008) took up the case of India's moviemaking industry as an informal setup in depicting the entire value chain of activities and the way various agents interact across the formal and informal sectors.

Contrasting with studies on overall informal economy, little research has delved into entrepreneurship in the informal sectors in India.

In a study to assess the impact of India's post-liberalization economic policies on entrepreneurs in the informal sectors, Gurtoo (2009) conducted a survey of 1255 workers engaged in the various informal sectors in India. Her findings were that the income of micro-enterprise owners (in the informal sector) was twice that of informal sector workers; informal entrepreneurs were happy to work in their professions and did not consider lack of alternatives as the drivers of their participation in the informal economy; and that they have limited access to formal welfare schemes. Equipped with the insight that entrepreneurship in India's informal sector is not predominantly necessity-driven, Gurtoo proposes a framework that could enable to unearth the hidden entrepreneurial culture existing in informal sectors of India. In another study on women entrepreneurs in the informal sectors located in the tier-1and tier-2 cities of India, Williams and Gurtoo (2011) highlight the role of '*entrepreneurial ecosystem*' in entrepreneurial ventures. Such networks help the focal entrepreneurs exert socio-cultural influence to perform a business, in the absence of economic influence that is available to the formal entrepreneurs.

In another set of studies, researchers have documented the improvisation abilities of people at the grassroots level in bringing about product and process innovations. Called as *jugaad*, a Hindi word for improvisation, such products and processes are good-enough remedies of immediate problems that people face. While there is an application of creativity, these outcomes cannot be deemed as truly innovative, as they often lack scalability and reliability (Krishnan, 2010). In a significant effort, the *Honey Bee Network*, as a part of the National Innovation Foundation in India, engages in documenting local knowledge, inventions, innovations, and improvisations carried out by people in the informal economy (Gupta, 2006).

Notwithstanding the efforts like those of the *Honey Bee Network*, and researchers studying women entrepreneurship and those of people on the margins of the formal economy, I observe a significant opportunity to explore creativity and innovation among entrepreneurs in the informal sector. Most of the research on creativity and innovation in the context of entrepreneurship has been set up in the formal sector (Carland, Hoy, Boulton, & Carland, 1984); hence, such an effort could also inform the global audience.

One could argue that creativity and innovation are much more required in the informal sector than in the formal. The very fact that the entrepreneur in the informal economy does not have the economic means to influence various stakeholders, she has to be far more ingenious. In a country like India where institutions, both hard and soft, are not adequately developed (The Economist, 2010), ingenuity could make the difference between survival and death while operating in the informal economy. Contextualize this with the fact that most participants in the informal sector come from lower strata of the economy, are not adequately educated, and have very few means of finances. Creativity and innovation become all the more vital under such circumstances.

Having argued for the existing gap in the literature of entrepreneurship in the informal economy, we now look at some attempts to study innovation and creativity among entrepreneurs in some of the informal sectors of India.

The Study

In one of the epic works in the field of entrepreneurship, Schumpeter (1934) emphasized on entrepreneur as the '*agent of economic change*', and placed innovation at the heart of the enterprise. He proposed that growth comes from '*new combinations of material and energy*' performed by entrepreneurs, and not by the accumulation of capital. The entrepreneur '*commercializes a new good or a new method of production, opens a new market or discovers a new source of supply, or carries out a new organization of industry*' (1934: 68). It is through the act of '*creative destruction*' that the economic equilibrium gets disturbed, and a new order gets created (Schumpeter, 1942).

Schumpeter placed the entrepreneurs in question squarely in the formal economy, and hence elegantly identified the types of innovations that the entrepreneur can bring about. But in an informal setup, there are several constraints imposed on the entrepreneur and the range of innovation activities get impacted consequently. For instance, the entrepreneur may not be able to bring about innovations that impact the industry structure, as Schumpeter would desire.

In an attempt to look at the innovative activities of an entrepreneur beyond Schumpeter's conceptualization, Manimala (1992) conducts a grounded study on entrepreneurs spanning formal and informal sectors in India. Manimala identifies ten types of innovations that such entrepreneurs usually engage in (1991: 7).

- ***Market/Marketing innovation*** *: This involves discovering a relatively new market, employing new market strategies to tap an unaddressed market, and erecting entry barriers for competitors.*
- ***Product innovation*** *: This comprises mainly of making modifications in the existing products and introduction of locally new products.*
- ***Process innovation:*** *Common methods in this category include modification of existing processes to circumvent patent protection, making use of locally available labor and resources to product cheaper alternatives of existing products, and bringing improvements in quality.*
- ***R&D management innovation:*** *Though rare, such an approach calls for devising novel ways of managing the R&D efforts without having*

formal departments, mostly by leveraging entrepreneurs' informal networks.

– ***Supply/Supply-source innovation*** *: Faced with a shortage of supply or lack of demand in the market, such engagements mostly involve vertical integration or partnership commitments.*
– ***Personnel innovation*** *: These innovations focus on building a continuous stream of trained personnel under situations where labor quantity and quality isn't adequate, and labor laws are weak or even inexistent.*
– ***Financial innovation*** *: Such innovations mostly involve mobilizing funds from outside rather than managing them internally. Some of the approaches are through chit-funds, micro-credits, and convertible debentures.*
– ***Cultural innovation*** *: In ensuring that the enterprise in its budding state works as a collective whole, entrepreneurs pay attention to institutionalizing a culture and a way of thinking. In the absence of legitimacy and other resources, such a culture creation calls for ingenuity.*
– ***Structural innovation*** *: Akin to the business model innovation, such a dimension looks at the way the enterprise is structured and the tradeoffs the entrepreneur exercises. This could involve subcontracting engagement, flexible working hours, or working-from-home kind of setups, among others.*
– ***Government relations innovation*** *: An often ignored feature, yet very necessary in the informal structure is the approach to managing the relationship with authorities and regulatory bodies.*

Manimala observes that '*successful entrepreneurs are innovative in some areas, during some phases (of their entrepreneurial journey), and at least in some degrees*' (1992: 18).

The present study documents the innovation and creativity aspects of selective entrepreneurs in the informal economy in India. Here we adopt the definition of creativity as '*the process of developing and expressing novel ideas that are likely to be useful*', and innovation as '*the embodiment, combination, and synthesis of knowledge in novel, relevant, valued new products, processes or services*' (Leonard & Swap, 1999). Since creativity is hard to observe unless manifested in some form of innovation, for the purpose of this paper, we focus on the innovative outcomes of entrepreneurs' engagement, instead of the creativity of the entrepreneur per se. With over 80 percent of India's non-agriculture employment absorbed in the informal economy, most of which is self-employment, studying the phenomenon of innovation remains a humongous task. The paper adopts some strict boundary conditions to identify the subjects of the study. These are:

- **The entrepreneur must have remained in the informal economy for over a five-year period.** The intent is to understand the reasons for which the entrepreneur has stayed in the informal sector. It must, however, be observed that illegal and black-market activities are kept strictly outside the purview of the study.
- **There must be at least one significant innovation introduced by the entrepreneur in the market.** While every entrepreneur engages with one of the ten kinds of innovations to varying degrees (Manimala, 1992), the subjects considered for this study must have excelled significantly in one or more of innovative dimensions as compared to the market in which they operate. Being first to the market is a useful heuristics to identify such subjects.
- **The entrepreneur must be actively involved in the day-to-day operation of the enterprise**. Entrepreneurs in the informal economy can take the form of serial-entrepreneurs or those managing a portfolio of business, or just providing funds to other entrepreneurs. While these are certainly legitimate and interesting cases to study, the present investigation focuses on those actively managing their enterprise, and by that token, would mostly be the owner-managers of their setup.

Identifying entrepreneurs meeting these criteria, especially with high levels of demonstrated innovation, is a rather tall task. The current study has managed to identify two such entrepreneurs based out of the *Koramangala* area of Bangalore. A cosmopolitan located in South Bangalore, *Koramangala* houses around a million people and is spread over an area of 1800 acres.[1]

[1] Gathered from multiple sources, including local newspaper supplements.

The identification happened through frequent visits to the area, references from friends and colleagues, and articles from the local newspapers.

The Tentative Findings

The project involves carrying out in-depth interviews with innovative entrepreneurs sustaining in the informal economy. So far, two entrepreneurs are identified and interviewed. The interview duration was 120 minutes and 90 minutes respectively, and this happened in two sittings. Appendices 1 and 2 provide the profile sketch of the two entrepreneurs. Here are the tentative insights gathered so far from this ongoing study.

- ***Graduation from necessity-driven to opportunity-driven entrepreneurship***: Both of our cases talk about entrepreneurs from the marginalized sections of the society. *Md. Fayaz* is from the Muslim community, which was marginalized during the 1970s when he started his journey, and *Amri Devi* is an immigrant from Rajasthan. Though their start would be deemed as necessity-driven, much in line with the prediction of Bosma and Levie (2010), they soon graduated to opportunity-driven entrepreneurship. For instance, well aware of the diseconomies and risks involved in the business of selling high-value dry fruit items on the street side, Fayaz continues enjoying his business. His risk appetite keeps his competitors at bay.
- ***Heuristics-driven decision making:*** Busenitz and Barney (1997) identify development and exercising of heuristics as a definitive feature of an entrepreneur. In our cases also, both *Md. Fayaz* and *Amri Devi* adopted simple pricing heuristics to run their businesses single-handedly. This is noticeable, especially in the backdrop of their absolute absence of any formal education or apprenticeship opportunity. Further, both the cases lacked any formal means of competitive benchmarking or availability of substitutes to arrive at appropriate pricing strategies. *Md. Fayaz* aimed at maintaining a

margin of 8 percent on dried fruits, while *Amri Devi* eyed for nothing less than INR 50 for a hand-made product. Anything above was welcome. Similar heuristics were adopted to manage the inventory levels, for in case of *Md. Fayaz*, the inventory carrying costs are very high. These simple rules reduced their cognitive load and let them 'enjoy' the endeavor.

- ***The knack of discovering new markets***: In his study of entrepreneurs in India, Manimala (1992) identified market/marketing innovation as the most common of all types of innovations exercised. In the two cases that we studied, there were extensive efforts laid in identifying the right market and the locations to do business in. *Md. Fayaz* recognized early on that Koramangala is upmarket, people are more cosmopolites, and would want to spend on buying dried fruits for health and hedonic reasons. He situated his shop at a major traffic junction on the 100 Ft. Road in Koramangala, and kept large glass jars displaying his products. Similarly, *Amri Devi* identified the need for hand-made decorative items for household and set her shop next to the busy *Forum Mall*. By doing so, they saturated the carrying capacity of the market and hence dissuaded competitive entry.
- ***The art of managing government relations:*** Another essential aspect Manimala (1992) identified of entrepreneurs, especially in emerging economies, is their innovation in managing relationships with authorities and regulators. Since our entrepreneurs operate in completely informal setup, they have to ward off misappropriation of their hard-earned money. For instance, *Mr. Fayaz* kept it very clear from the outset that he would not pay any money to police or any local *mafia*. However, he would be okay to feed them his dried fruits once in a while. In fact, he deems feeding them would earn their loyalty and blessings from his *Maalik*. The case of *Amri Devi* is even more important in the way she managed to get a reasonably good house, with free electricity and water supply in the Koramangala locality, where a similar house would have cost her anywhere above INR 6000 per month as rents. We call this as the art of managing

relations, as the entrepreneurs highlight the adoption of socio-cultural pulls, instead of economic mechanisms to play in the informal economy, as also depicted by Williams and Gurtoo (2011).

As we identify more entrepreneurs who have brought about remarkable innovations while continuing with the informal economy, we would gather more insights onto our working paper journey.

Conclusion

The paper was an attempt to look at the creativity and innovation dimensions of the entrepreneurs operating in the informal economy. The informal economy, whether it is in developing nations or developed ones, offers a fascinating setup to study entrepreneurial activities. India alone has seen its share of studies on entrepreneurs in the informal economy. However, the study identifies that not much focus has gone into studying the innovations that such setups espouse among entrepreneurs. Hence, the paper studies a set of entrepreneurs who have stayed in the informal economy for a long time, have introduced significant innovations and are still actively managing their enterprise.

Based on the little investigation, the insights gathered suggest that though the genesis of entrepreneurship could be necessity-driven, entrepreneurs may shift to opportunity-driven, once they experience success, and build a taste of doing business. Secondly, in spite of no formal education, or maybe because of it, such entrepreneurs rely heavily on simple rules of thumb for pricing decisions and running their business mindlessly. Regarding innovation, the two entrepreneurs demonstrate remarkable abilities in identifying the right markets and localities to serve and set up their business in, and in developing a beneficiary relation with the regulators in the formal economy. This remains a working paper, and would attempt to gather more cases to deepen and broaden the investigation on innovation and creativity in the informal sector.

Appendix 1

Mohammad Fayaz is a street vendor selling **high-quality dried fruits** in the 5th Block locality of *Koramangala*. Aged 51, Fayaz has been a self-employed agent in the informal economy for past 40 years. His first experience of entrepreneurship was at a tender age of 10, when he used to sell bananas in the *Malleswaram* area of Bangalore. Middle among his other four brothers, Fayaz was pushed into entrepreneurship by his circumstances at an early age. Since then, he graduated to selling fruits in the *Yeshwantpur* and *Malleswaram* areas, and for the past 10 years, he has setup this dried fruits shop in *Koramangala*.

He, along with his wife, mostly attends to the shop. The business is essentially sourcing dried fruits, like almond, walnut, figs, dates, raisins, apricots, peaches sources from New Delhi, and other items like spices and cashew nuts bought from interior and coastal parts of Karnataka and Goa. Almost all trade happens on off-the-book basis, and all contracts are verbal.

His customers range from homemakers, to college goers, office goers, and even auto drivers. Fayaz estimates that at any given time, he carries an inventory of about INR 150,000 at his shop. He sells commodities worth INR 8000 on an average on the weekday and averages around INR 12,000 on weekends. He maintains a 10 percent profit margin on dry fruits and almost 18 to 20 percent margin on spices. Of every 100 customers that visit his shop, ten make a purchase. That makes an average earning of INR 800 on a normal day and INR 1200 on a good day.

Our entrepreneur deems that not only in *Koramangala*, but also anywhere in Karnataka that such a shop exists! He reasons this aversion of people getting into this business and low competition to the high risk the business involves. Typically, businessmen would prefer dealing with low-value, high-turnover items, as compared to selling dried fruits on the street side. According to Fayaz, an investment of over INR 200,000 for returns of INR 1000 per day keeps most of his competition at bay, but for him, he enjoys this business.

He keeps his condiments in large glass jars where customers could see the quality for their satisfaction and occasionally taste dried fruits before making a purchase. He deems this strategy to work out, as people prefer buying dried fruits in open as against in packets where the quality might be suspected. That places him at an advantage as against formal shops selling packaged dried fruits. High entry cost and value of item is his entry barrier for competitors. He however took loan from one of his friends 10 years back to get into this line of business.

Fayaz has none employed to attend to the shop; however, he appoints a night watchmen who looks after the carts during night, and is paid INR 100 per day. In terms of informal arrangement with the local authorities and police, the entrepreneur does not pay any protection charges, but instead feeds the police officer with his dried fruits once in a while, if they ask for some favors. He keeps the shop closed on Friday, and on other days operates between 9 AM and 9 PM with regular lunch breaks, when her wife attends to the shop.

Fayaz is a very straightforward person and has a very strong faith in God and destiny. He believes that God, he calls him '*Maalik*', has asked him to do this business, and with His kindness he makes a living. On his philosophies, he believes that his duty is to serve the customers with the best possible product and not get upset if the customer does not buy or does not return. His strategy of inducing repeat purchase is to delight the customer with good quality product. With strictly no bargaining, he however may choose to tender a little extra 10 grams while selling to a customer he deems needy.

On his expansion plans, Fayaz looks very satisfied with his current setup, and 'enjoys' his work. He has not expanded in the last 10 years, and does not plan to do so, for he thinks expansion would bring along headache and he may not enjoy what he is doing.

Carts carrying over INR 150,000 of goods left on a regular Friday off

Engaging a customer on a Saturday noon

Appendix 2

Amri Devi, aged 50, is a **handicrafts maker** with a roadside shop opposite *Forum Mall* in *Koramangala*. A mother of six, Amri migrated from *Pali* district of Rajasthan some 40 years back in search of better livelihood. She started her business in *Koramangala* even before the time the locality existed. Most of her time was spent on the roadside, rearing a large family and enabling her kids to attend school, which they managed to.

Amri's shop has handicraft items, wooden items, terracotta vases, and clay products. Except for the terracotta vases, which she sources from a vendor based in interiors of Andhra Pradesh, all other items are made at her home. Amri employs her nephew in the mould making process, and she herself does the painting of the produce. For instance, she displays a two feet tall statue of *Lord Krishna*. The approach is that she buys good-looking statues from a shop, creates mould from it, and then starts making replicas to be sold at a lower cost. Such statues would be sold at INR 500 on a normal day. Terracotta vases could fetch her anywhere between INR 300 to INR 500, on a cost of INR 150, whereas the smaller clay items could get her a margin of INR 50 on an INR 150 product. Of the 100 customers that stop by her shop, 5 make a purchase. This makes her daily earning to be around INR 500, at sales of INR 1200. But since most of her items are made by her family, the margins are rather okay for sustenance.

As for her finances, she does not have a bank account, and mostly deals with the supplier of terracotta vases and other products in an informal manner. Whatever money is left after meeting the household expenses, she spends that money sourcing newer products to be displayed at her boutique.

She was allegedly the very first vendor selling such items in this locality, and pretty much remained so, till about recently. The most interesting part of Amri's entrepreneurial journey is her struggle in getting a place for her family of eight. In last several years, her family has been displaced at least a dozen times. Every time she had to go to the local police station, and plea for the future of her children. She finally managed to convince the local authorities and police to let her run her roadside boutique. Listening to her struggles would fill your eyes, but she looks thrilled about what she is doing, and is proud of her journey so far.

Her struggles with the local administration have made her earn a house, with free electricity and water connection. This small setup measuring 20 × 20 feet accommodates her family of 10 now, and just outside is her shop.

As for the future plans, Amri is confident of sustaining her current setup, as now her kids are well placed to take care of themselves, she has a place to stay with her husband and sons, and she likes the business. She says that the current setup keeps her busy meaningfully, keeps her with her family and grandchildren, and that is how she wants to lead her life. Not planning too much into the future, Amri rests a lot of hope on God, and is neither too eager to grow nor too upset with her current state of affairs.

Roadside display of clay items, show pieces, and vases

A small setup in the backyard to mould clay items

Coloring the bought out terracotta vases

References

Athique, A. (2008). The global dynamics of Indian media piracy: Export markets, playback media and the informal economy. *Media, Culture and Society, 30*(5), 699–717.

Awwad, N. A. (2012). Debating the informal economy: Considering Colonialism and Palestine. *Review of Women Studies (Special Issue), 1*, 52–66.

Bosma, N., & Levie, J. (2010). *Global entrepreneurship monitor: 2009 global report*. Babson Park: Babson College.

Breman, J. (1996). *Footloose labour: Working in India's informal economy*. Cambridge: Cambridge University Press.

Busenitz, L. W., & Barney, J. B. (1997). Differences between entrepreneurs and managers in large organizations: Biases and heuristics in strategic decision-making. *Journal of Business Venturing, 12*(1), 9–30.

Carland, J. W., Hoy, F., Boulton, W. R., & Carland, J. A. C. (1984). Differentiating entrepreneurs from small business owners: A conceptualization. *Academy of Management Review, 9*(2), 354–359.

Carr, M., & Chen, M. A. (2001). *Globalization and the informal economy: How global trade and investment impact on the working poor*. Cambridge, MA: A WEIGO Publication.

Cross, J. (2000). Street vendors, and post-modernity: Conflict and compromise in the global economy. *International Journal of Sociology and Social Policy, 20*(1/2), 29–51.

Dasgupta, S., & Singh, A. (2005). Will services be the new engine of Indian economic growth? *Development and Change, 36*(6), 1035–1057.

De Soto, H. (1993, September11). The missing ingredient. *The Economist*, pp. 11–14.

Gerxhani, K. (2004). The informal sector in developed and less developed countries: A literature survey. *Public Choice, 120*(3), 267–300.

Gupta, A. K. (2006). From sink to source: The Honey Bee Network documents indigenous knowledge and innovations in India. *Innovations: Technology, Governance, Globalization, 1*(3), 49–66.

Gurtoo, A. (2009). Policy support for informal sector entrepreneurship: Micro-enterprises in India. *Journal of Developmental Entrepreneurship, 14*(2), 181–194.

Harris-White, B., & Sinha, A. (2007). *Trade liberalization and India's informal economy*. New Delhi/New York: Oxford University Press.

Hart, K. (1973). Informal income opportunities and urban employment in Ghana. *The Journal of Modern African Studies, 11*(01), 61–89.

Hill, E. (2001). Women in the Indian informal economy: Collective strategies for work life improvement and development. *Work, Employment and Society, 15*(3), 443–464.

ILO. (2012). *Statistical update on employment in the informal economy*. Geneva: ILO—Department of Statistics.

Jütting, J., Parlevliet, J., & Xenogiani, T. (2008). *Informal employment re-loaded* (Working paper No. 266). Paris: OECD Development Centre.

Krishnan, R. T. (2010). *From jugaad to systematic innovation, the challenge for India*. Bangalore: Utpreraka Foundation.

Leonard, D., & Swap, C. (1999). *When sparks fly: Harnessing the power of group creativity*. Boston: Harvard Business School Press.

Maloney, W. F. (2004). Informality revisited. *World Development, 32*(7), 1159–1178.

Manimala, M. J. (1992). Entrepreneurial innovation: Beyond Schumpeter. *Creativity and Innovation Management, 1*(1), 46–55.

Piore, M. J., & Sabel, C. F. (1984). *The second industrial divide: Possibilities for prosperity*. New York: Basic Books.

Portes, A., Castells, M., & Benton, L. A. (Eds.). (1989). *The informal economy: Studies in advanced and less developed countries*. Baltimore: Johns Hopkins University Press.

Schumpeter, J. A. (1934). *The theory of economic development*. New York: McGraw Hill/Harper.

Schumpeter, J. A. (1942). *Capitalism, socialism and democracy*. New York: McGraw Hill/Harper.

Snyder, K. A. (2003). Working off the books: Patterns of informal market participation within New York's East village. *Sociological Inquiry, 73*(2), 284–308.

Stebbins, R. A. (1982). Serious leisure: A conceptual statement. *The Pacific Sociological Review, 25*(2), 251–272.

Swaminathan, M. (1991). *Understanding the 'informal sector': A survey* (WIDER working paper 95/1991). Helsinki: World Institute for Development Economics Research of the United Nations University.

The Economist. (2010, September 10). Business in India: A bumpier but freer road.

Trebilcock, A. (2005). *Decent work and the informal economy* (WIDER discussion papers , 2005/04). Helsinki: World Institute for Development Economics (UNU-WIDER).

Williams, C. C. (2007). Entrepreneurs operating in the informal economy: Necessity or opportunity driven? *Journal of Small Business and Entrepreneurship, 20*(3), 309–319.
Williams, C. C. (2008). Beyond necessity-driven versus opportunity-driven entrepreneurship a study of informal entrepreneurs in England, Russia and Ukraine. *The International Journal of Entrepreneurship and Innovation, 9*(3), 157–165.
Williams, C. C., & Gurtoo, A. (2011). Evaluating women entrepreneurs in the informal sector: Some evidence from India. *Journal of Developmental Entrepreneurship, 16*(3), 351–369.
Williams, C. C., & Nadin, S. (2010). Entrepreneurship and the informal economy: An overview. *Journal of Developmental Entrepreneurship, 15*(4), 361–378.

11

Determinants of Export Performance: An Empirical Analysis of the Indian Pharmaceutical and Automobile Industries

Satyanarayana Rentala, Byram Anand, and Majid Shaban

Introduction

The past few decades have witnessed a remarkable increase in the worldwide internationalization of businesses. Competition in many markets has intensified, across a wide variety of industries. The formation of various trade agreements and liberalized trade policies, involving both developing and developed countries, has led to an increase in global trade volumes. Meanwhile, the integration of world markets and multilateral trade activities among various countries has resulted in an expansion of international trade, which is now valued at US $18.3 trillion (World Trade Organization, 2011).

In the recent past, international trade was dominated by developed economies such as the USA, Germany, Japan, and the UK. Though these countries still account for large export shares, many developing

S. Rentala (✉) • B. Anand • M. Shaban
Pondicherry University, Pondicherry, India
e-mail: rentsatya@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_11

economies, including China, have achieved substantial gains in market share. As seen from the data in Table 11.1, China has taken over as the leader in world trade, followed by the USA, Germany, Japan, and the Netherlands. India is ranked 19th; the top 19 countries contribute over 68 % of world trade.

Analysis of India's export trade statistics, as shown in Table 11.2, reveals that Indian exports are valued at US $3.05 trillion. The five leading partner regions for India's export trade are the European Union (EU), United Arab Emirates, the USA, China, and Singapore, which together account for nearly 52 % of Indian export trade value. As per World Trade Organization data, India is ranked 19th among all the exporting countries and 12th in importing.

Table 11.1 World trade statistics—2011

Country	Value in US $ millions	% share
China	1,898,381	10.40
USA	1,480,432	8.11
Germany	1,472,281	8.07
Japan	822,564	4.51
Netherlands	661,015	3.62
France	596,068	3.27
Korea, Republic of	555,214	3.04
Italy	523,183	2.87
Russian Federation	522,013	2.86
Belgium	476,660	2.61
UK	473,191	2.59
Hong Kong	455,650	2.50
Canada	452,444	2.48
Singapore	409,503	2.24
Kingdom of Saudi Arabia	364,736	2.00
Mexico	349,569	1.91
Spain	308,700	1.69
Taipei, Chinese	308,257	1.69
India	304,585	1.67
Share of Top 19 Countries	**12,434,445**	**68.12**
Total	**18,255,000**	**100**

Source: Compiled from WTO Statistics, 2011

Table 11.2 India's export trade statistics—2011

Leading export partner	Value in (US $ millions)
European Union (27)	54,611
United Arab Emirates	37,369
USA	32,919
China	16,718
Singapore	15,628
Total leading partners' exports	**157,244**
Total exports—India	**304,585**
Leading partner share in exports	**51.6**

Source: Compiled from WTO Statistics, 2011

With the liberalization of the Indian economy after 1991, the country's pharmaceutical and automobile industries are well-placed to tap export marketing opportunities, not only in developed economies such as the USA and EU, but also in many other emerging economies across the world. The Indian pharmaceutical industry stands a great chance of exploiting export marketing prospects, due to increased use of generic and low-priced branded generic formulations in both developed and developing economies. The other opportunity presenting itself is the result of many patented drugs going off-patent in the near future, offering a boost to the export scenario of Indian pharmaceutical products in a variety of markets. Indian automobile companies are also presented with opportunities, due to growth in demand for automobile brands in both domestic and export markets. With the entry of many foreign multinational automobile brands into India and the accompanying establishment of manufacturing facilities, the growth prospects for the Indian automobile components manufacturing industry have increased tremendously.

This chapter explores the determinants of export performance in the context of the Indian pharmaceutical and automobile industries. Among many determinants of export performance examined in various earlier studies, firm-level characteristics, specifically sales values, export sales, profitability, and research and development (R&D) expenditures, are considered. We analyze the association of exports with the other variables using multiple regression analysis, building on the existing literature.

Industry Overviews

The Indian Pharmaceutical Industry

India is one of the fastest growing pharmaceutical markets in the world, and has established itself as a global manufacturing and research hub for this industry. A large raw material base and the availability of a skilled workforce offer competitive advantage to Indian pharmaceutical firms. The Indian pharmaceutical industry was estimated to be worth US $21.5 billion in 2009–10 and was expected to touch US $40 billion by 2015. Globally, India ranks 3rd in terms of volume of production and 14th in terms of value.

In addition to strong international performance, the domestic market was expected to grow from US $13 billion in 2009–10 to US $20 billion by 2015. The domestic pharmaceutical sector is witnessing strong growth due to higher penetration rates in tier-II and tier-III cities and greater focus on the largely untapped rural market. Improvements in healthcare delivery and increased healthcare insurance have further accelerated domestic market growth. In recent years, the industry has been witnessing a strong wave of modernization and technological upgrading. This has resulted in a shift from manufacturing tablets and capsules to high value, specialty products like injection formulations and novel drug delivery systems, vertical integration and horizontal consolidation of production processes, development of supply chain management, and improvements in productivity.

The Indian pharmaceutical market is expected to grow at a compound annual growth rate (CAGR) of 14–17 % between 2012 and 2016. India is now among the top five pharmaceutical emerging markets, along with China, Brazil, Russia, and Venezuela. On the back of increasing sales of generic medicines, continued growth in chronic therapies, and greater penetration in rural markets, the domestic pharmaceutical market was expected to register a strong double-digit growth of 13–14 % in 2013. The year 2012 closed with a growth of 12 %, according to data from the research firm IMS Health (IMS IMS Health, 2012).

India's exports of drugs, pharmaceutical, and fine chemicals grew by 27 % to Rs. 60,000 crore (US $11.19 billion) for the year ended March 2012, according to data compiled by Pharmaceutical Exports Council

Table 11.3 India's pharmaceutical export trends

Year	Pharmaceutical exports	Pharmaceutical net exports
	US $ billions	US $ billions
2008	4.9	4.1
2009	4.9	3.9
2010	6.0	5.1
2011	7.0	6.1
2012	8.0	7.0
2013 F	9.8	8.6
2014 F	12.0	10.7
2015 F	14.7	13.3
2016 F	18.2	16.5

Source: Compiled from BMI, Aranca; "F" = Forecast

of India (Pharmaceutical Exports Council of India (Pharmexcil), 2012). The Ministry of Commerce proposed an ambitious strategic plan to double pharmaceutical exports from US $10.4 billion in 2009–10 to US $25 billion by 2013–14. The Government also planned a "Pharma India" brand promotion action plan, spanning a three-year period, to give an impetus to generic exports.

As seen in Table 11.3, India's pharmaceutical exports are forecasted to continue to increase sharply, yielding a large trade surplus for this industry in India.

The Indian Automobile and Components Industry

The Indian automotive components industry is expected to reach a turnover worth US $113 billion by 2020–21, from US $43.4 billion in 2011–12, according to an Automotive Component Manufacturers' Association (ACMA) report. The exports from the industry are expected to grow at a CAGR of 17 % during 2012–21 (ACMA, 2011). As can be observed from Table 11.4, two-wheelers and passenger vehicles have shown the highest growth among various vehicle categories. Table 11.5 shows considerable growth in both total sales and exports during the second half of the 2000s.

Table 11.4 Export Trends for individual vehicle categories (in 2000s)

Category	2003–04	2004–05	2005–06	2006–07	2007–08	2008–09	2009–10	CAGR
Passenger vehicles	129.3	166.4	175.6	198.5	218.4	335.7	446.1	22.9
Commercial vehicles	17.4	29.9	40.6	49.5	59.0	42.6	45.0	17.1
Three-wheelers	68.1	66.8	76.9	143.9	141.2	148.1	173.3	16.8
Two-wheelers	265.1	366.4	513.2	619.6	819.7	1004.2	1140.2	27.5

Source: Compiled from http://www.siamindia.com/scripts/export-trend.aspx

Table 11.5 Export trends for Indian auto-components industry

Year	Annual sales (US $ billions)	Exports (US $ billions)
2004–05	8.7	1.7
2005–06	12	2.5
2006–07	15	2.7
2007–08	18	3.5
2008–09	19	3.8
2009–10	22	4.3

Source: Compiled from http://www.ibef.org/industry/autocomponents.aspx and "Indian Auto Component Industry—an Overview", Auto-Component Manufacturers Association of India (2011), www.acmainfo.com

Indian Pharmaceutical and Automobile Exports

Table 11.6 presents India's export trends: total, pharmaceutical, and automobile. All three have demonstrated gradual increases during the period 1990–2011. Total Indian exports crossed the US $1 trillion mark in 2005 and reached US $3 trillion in 2011. Indian pharmaceutical exports increased from US $1.6 billion to US $70 billion during the same period, and the automobile exports increased from US $0.2 billion to US $36.2 billion. The calculated CAGR values during the 22-year period from 1990 until 2011 were 13.7 %, 18.8 %, and 25.9 %, for total Indian exports, pharmaceutical exports, and automobile exports, respectively. Thus, the two focal sectors for this study have grown at higher rates than the overall export scenario in India.

Table 11.6 India's export trade statistics—pharmaceuticals and automobiles

Year	Total exports US $ billion	Pharmaceutical exports (Packed medicines) US $ billions	Automobile exports (passenger cars) US $ billions
1990	179.4	1.6	0.2
1991	179.0	3.2	0.7
1992	207.1	2.8	0.8
1993	222.4	3.1	0.9
1994	263.3	3.7	1.4
1995	317.0	4.9	1.8
1996	334.7	5.2	2.4
1997	347.9	5.9	2.1
1998	332.1	5.5	1.3
1999	369.2	6.3	0.9
2000	423.6	6.6	1.0
2001	438.8	7.6	0.9
2002	501.0	9.5	1.5
2003	593.6	11.8	4.2
2004	759.0	14.7	7.3
2005	1003.5	20.1	9.5
2006	1212.0	24.5	10.4
2007	1459.0	30.8	12.8
2008	1818.6	41.3	22.2
2009	1767.7	39.7	29.4
2010	2204.1	51.5	45.1
2011	3014.8	70.0	36.2
CAGR	**13.7**	**18.8**	**25.9**

Source: Compiled from OECD Data (1990–2011) http://stats.oecd.org

Literature Review

Cooper and Kleinschmidt (1985) studied the impact of export strategy on export sales performance. It was observed that export performance has been traditionally measured by a single variable, namely export sales as a percent of total corporate sales, called export intensity. Cavusgil and Zou (1994) studied the marketing strategy–performance relationship with respect to export ventures. A comprehensive set of potential determinants of export market performance was considered and concluded that export marketing strategy, firm's international competence, and managerial commitment are the key determinants of export performance.

Katsikeas and Morgan (1994) studied the differences in perceptions of export problems based on firm size and export market experience. It was noted that there is some consensus that larger firms possess more resources and achieve higher levels of economies of scale. Katsikeas, Deng, and Wortzel (1997) studied the perceived export success factors of small and medium-sized Canadian firms. The study concluded that a firm's successful export activity is associated with respect to different exporter categories in terms of degree of internationalization, company size, and product type.

Hoang (1998) studied the relationships between firm characteristics, international marketing strategies, and export performance of firms. Firm characteristics, in this study, were referred to as the demographics of a firm. It was reported that among the variables that characterize a firm, firm size has received the maximum attention. Francis and Collins-Dodd (2000) studied the impact of firm's export orientation on the export performance with respect to high-tech small and medium enterprises. The study concluded that export intensity, export sales, export intensity growth, and export gross margin profitability had a significant relationship with export performance.

Leonidou, Katsikeas, and Samiee (2002) investigated the marketing strategy determinants of export performance through a meta-analysis study. It was concluded that, in general, there appears to be a strong association between export marketing strategy and export performance measures. Sousa (2004) presented an evaluation of empirical research in literature regarding export performance measurement. The literature review reported the studies that used the size of the firm as a variable, most focused on the export performance of small- to medium-sized firms.

Calantone, Kim, Schmidt, and Cavusgil (2006) reported the results of a cross-country (USA, Korea, and Japan) study on the influence of internal and external firm factors on international product adaptation strategy and export performance. It was concluded that the greater the export dependence of a firm, the greater is the product adaptation strategy. Diamantopoulos and Kakkos (2007) developed an assessment performance measurement framework to understand firm's export performance. A performance measurement matrix was designed using various variables like export sales levels, export market share, export sales intensity, export sales growth, change in export market share, and change in export sales intensity.

Saranga (2007) studied the relationships between R&D expenditure and export performance of Indian pharmaceutical companies. The study reported that low R&D expenditures resulted in low export performance. The study studied the interrelationships between variables like profit margins, total sales (firm size), export sales, and R&D investments. Banerji (2012) studied the export trends of Indian pharmaceutical and automobile industries. Co-relation between auto-component exports and automobile exports, and R&D expenditures and pharmaceutical exports was also studied. The study concluded that there is a strong association between R&D expenditure and filing of new patents.

Serra, Pointon, and Abdou (2012) studied the various factors influencing the propensity to export among UK and Portuguese textile firms. The fundamental research questions revolved around finding the demographic characteristics of the firm that are associated with stronger export propensity. The study concluded that there is a strong association between demographic characteristics and export performance.

Research Gap

Literature review of the previous studies indicates that demographic characteristics of a firm had a significant impact on export performance of firms. Many of the studies were conducted mainly in the context of USA and European countries, though some studies were done on companies in Asia (Korea and Japan). Very few studies have been reported in the context of emerging economies, especially with reference to India. Hence this study attempts to examine the determinants of export performance in Indian context. Due to their knowledge and technology-intensive nature, the study focuses on pharmaceutical and automobiles industries in India.

Objectives of the Study

The broad objectives of this study are to understand the various determinants of export performance, to analyze the export performance of Indian pharmaceutical and automobile companies, and to understand the interrelationships between various demographic variables. The variables considered are firm size, export sales, profit-after-tax, and R&D expenditure.

Methodology

Data and Sample Selection

The list of BSE-500 index companies is considered for analysis using PROWESS—a Centre for Monitoring Indian Economy database. All the index companies have been categorized into various industries. It is observed that 37 companies belong to the healthcare industry and 23 companies belong to the automobile industry (including auto-components manufacturing companies). Among the companies belonging to the healthcare industry, only those companies engaged in pharmaceutical product exports have been considered and this resulted in elimination of two companies from the list of 37 companies since they belong to the hospital industry. From the remaining list of companies, all the multinational pharmaceutical companies have been excluded from the analysis since this study is limited only to the analysis of export performance of Indian pharmaceutical companies. A final sample of 23 companies is considered for the analysis, taking the data availability into consideration. Similarly, from the list of 23 companies, the final sample size considered for the automobile industry is 17.

Variable Selection

Analysis is undertaken using total sales, export sales (Cooper & Kleinschmidt, 1985; Hoang, 1998; Katsikeas, Deng, & Wortzel, 1997; Saranga, 2007; Banerji, 2012), R&D expenditure (Saranga, 2007; Banerji, 2012), and profit-after-tax (Saranga, 2007) for the five-year period starting from 2007 to 2008 through 2011–12.

Data have been analyzed using descriptive statistics and CAGR. In addition, two regression models have been separately framed for the study of pharmaceutical and automobile industries.

Analysis and Discussion

It can be seen from Table 11.7 that, with two exceptions (Glenmark Pharmaceuticals and Orchid Pharmaceuticals), the sample companies

Table 11.7 Pharmaceutical industry—CAGR (2007–08 to 2011–12)

Company	Exp.	Sales	PAT	R&D
Aurobindo Pharma Ltd.	21.6	16.1	26.6	9.0
Biocon Ltd.	8.7	14.6	−12.5	21.2
Cadila Healthcare Ltd.	32.8	10.6	29.2	27.6
Cipla Ltd.	15.1	13.3	12.5	10.6
Claris Lifesciences Ltd.	15.5	4.3	−2.0	−29.4
Dabur India Ltd.	15.5	15.6	10.0	39.0
Divi's Laboratories Ltd.	13.7	15.5	11.5	14.1
Dr. Reddy's Laboratories Ltd.	21.0	17.0	17.7	17.1
Elder Pharmaceuticals Ltd.	4.7	15.1	4.8	14.5
F D C Ltd.	21.0	7.8	19.2	15.5
Glenmark Pharmaceuticals Ltd.	−5.5	3.8	−9.1	10.7
Ipca Laboratories Ltd.	27.2	20.8	18.7	46.8
J B Chemicals & Pharmaceuticals Ltd.	1.0	3.7	87.8	22.1
Jubilant Life Sciences Ltd.	12.2	5.5	−10.6	18.0
Natco Pharma Ltd.	17.8	16.5	11.6	11.1
Orchid Chemicals & Pharmaceuticals Ltd.	−4.3	8.8	1.1	9.4
Piramal Enterprises Ltd.	9.5	−12.7	−18.9	60.8
Ranbaxy Laboratories Ltd.	21.1	20.3	22.7	2.3
Strides Arcolab Ltd.	13.8	16.1	165.2	−16.3
Sun Pharmaceutical Ltd.	16.1	0.5	17.5	8.7
Torrent Pharmaceuticals Ltd.	35.9	20.1	18.9	7.6
Unichem Laboratories Ltd.	19.3	8.0	1.5	16.5
Wockhardt Ltd.	35.1	22.3	−3.7	5.9
Total Industry	**17.2**	**12.6**	**−5.0**	**13.4**

have shown a very healthy export growth rate, with 10 growing faster than the industry growth of 17.2 % in terms of export sales. When we consider the size of the firms in terms of the sales values, only one company (Piramal Enterprises) has shown a negative growth rate. This can be attributed to the fact that during the period considered for the analysis, the pharmaceutical formulations business of Piramal Enterprises was bought out by Abbot India Limited.

In total, 13 companies have shown a higher growth rate in sales than the industry growth rate of 12.6 %. When we consider the profit-after-tax variable, the industry has de-grown by 5 %. This is due to the fact that large corporations like Ranbaxy Labs, Aurobindo Pharma, Dabur, and so on have undergone financial restructuring due to their mergers/acquisitions by multinational pharmaceutical companies. All the companies except two (Claris Life Sciences and Strides Arco Labs) have shown a growth in the R&D expenditure over the five-year period. In general it can be observed that all the pharmaceutical companies have increased their R&D expenditures to increase their domestic and export sales.

Based on the data presented in Table 11.8, it can be observed that all the automobile and auto-components companies have shown a healthy growth in exports except one company (Eicher Motors). Six companies have posted an export growth rate higher than the industry average rate of 22.5 %. All the companies except Eicher Motors have shown a healthy growth rates in sales. Four companies have grown at a higher rate than the industry growth rate of 17.6 %. When we consider the profit-after-tax variable, except Tata Motors and Maruti Suzuki, all the other companies have posted a positive growth rate. This could be due to large investments in R&D expenditure by Tata Motors and Maruti Suzuki. As can be seen from the R&D expenditure data, excepting Eicher Motors and Amara Raja Batteries, most of the other firms have invested considerably in the R&D during the period considered for the study.

Export intensity is an important variable in the demographic profile of the companies when we analyze the export performance. It can be seen from Table 11.9 that almost all the companies in the pharmaceutical

Table 11.8 Automobile industry—CAGR (2007–08 to 2011–12)

Company	Exp.	Sales	PAT	R&D
Ashok Leyland Ltd.	19.7	11.4	4.8	24.2
Bajaj Auto Ltd.	33.2	20.2	41.2	12.7
Eicher Motors Ltd.	–28.2	–26.4	18.6	–28.5
Escorts Ltd.	8.7	18.6	55.6	28.4
Hero Motocorp Ltd.	25.3	19.5	25.2	26.0
Mahindra & Mahindra Ltd.	22.1	27.5	27.1	24.5
Maruti Suzuki India Ltd.	49.4	16.5	–1.4	55.3
T V S Motor Co. Ltd.	36.2	20.4	66.8	14.0
Tata Motors Ltd.	7.2	16.2	–11.5	77.4
Amara Raja Batteries Ltd.	30.5	17.5	22.9	–4.3
Bharat Forge Ltd.	16.2	13.0	7.3	4.3
Bosch Ltd.	11.3	15.7	16.5	17.4
Exide Industries Ltd.	8.0	11.9	16.5	13.7
F A G Bearings India Ltd.	15.0	17.8	22.0	18.9
Motherson Sumi Systems Ltd.	18.2	26.3	25.4	53.2
Sundram Fasteners Ltd.	17.2	14.2	12.8	42.6
Wabco India Ltd.	66.5	15.6	21.7	0.9
Total Industry	**22.5**	**17.6**	**14.6**	**38.4**

Table 11.9 Export intensity—pharmaceutical industry

Company	2007–08	2008–09	2009–10	2010–11	2011–12
Aurobindo Pharma Ltd.	55.6	60.5	62.9	63.8	66.8
Biocon Ltd.	52.8	49.3	40.5	32.8	42.6
Cadila Healthcare Ltd.	24.8	36.1	48.9	51.3	51.6
Cipla Ltd.	48.9	51.7	51.1	52.5	52.2
Claris Lifesciences Ltd.	27.8	35.5	46.2	47.5	41.9
Dabur India Ltd.	4.4	4.5	4.3	4.0	4.4
Divi's Laboratories Ltd.	91.9	91.7	88.5	88.9	86.4
Dr. Reddy's Laboratories Ltd.	62.5	63.8	61.7	63.5	71.4
Elder Pharmaceuticals Ltd.	4.1	2.3	2.5	2.7	2.8
F D C Ltd.	7.5	8.5	8.8	9.4	11.8
Glenmark Pharmaceuticals Ltd.	48.1	23.7	25.6	24.7	33.1
Ipca Laboratories Ltd.	46.1	49.1	48.2	50.9	56.7
J B Chem. & Pharma. Ltd.	55.2	64.2	60.9	60.3	49.6
Jubilant Life Sciences Ltd.	38.8	42.2	43.3	49.7	49.7
Natco Pharma Ltd.	39.1	38.1	30.8	36.8	40.8
Orchid Chem. & Pharma. Ltd.	80.7	77.5	77.6	43.2	48.4
Piramal Enterprises Ltd.	22.7	23.8	13.6	51.8	56.0
Ranbaxy Laboratories Ltd.	68.8	67.5	59.6	62.0	70.6
Strides Arcolab Ltd.	77.6	74.9	69.6	62.1	71.6
Sun Pharmaceutical Inds. Ltd.	33.2	28.7	44.9	44.7	59.0
Torrent Pharmaceuticals Ltd.	22.2	27.8	30.7	32.9	36.4
Unichem Laboratories Ltd.	18.6	20.6	17.8	18.9	27.7
Wockhardt Ltd.	31.7	36.0	36.6	38.4	47.1
Industry Total	**45.1**	**46.2**	**45.5**	**48.1**	**53.0**

industry are highly dependent on export sales which determines their firm size. It can be seen that the average export intensity of all the sample firms considered for the study is 53 %, which indicates that growth in exports is a critical determinant to the overall sales performance of all the firms.

In comparison to the pharmaceutical industry, the average export intensity of all the automobile and auto-components firms considered for the study is only 10 %. This indicates that there is scope for the automobile firms to expand into foreign markets, thereby increasing their export intensity. With the future potential of the global automobile markets coupled with the potential for exports of auto-components, the automobile industry can be expected to increase its export intensity in the near future. As can be seen from Table 11.10, Bajaj Auto, Bharat Forge, and

Table 11.10 Export intensity—automobile industry

Company	2007–08	2008–09	2009–10	2010–11	2011–12
Ashok Leyland Ltd.	8.2	12.6	7.5	8.9	11.0
Bajaj Auto Ltd.	20.9	27.5	26.2	25.7	31.5
Eicher Motors Ltd.	6.7	6.7	7.4	7.1	6.1
Escorts Ltd.	5.0	7.1	2.3	6.6	3.5
Hero Motocorp Ltd.	1.9	1.7	1.9	2.1	2.3
Mahindra & Mahindra Ltd.	6.1	4.3	3.5	4.1	5.1
Maruti Suzuki India Ltd.	3.5	6.4	14.1	8.6	9.4
T V S Motor Co. Ltd.	8.8	12.7	11.2	12.6	14.4
Tata Motors Ltd.	8.5	8.2	5.0	6.6	6.1
Amara Raja Batteries Ltd.	2.9	2.8	3.1	4.3	4.5
Bharat Forge Ltd.	40.1	46.6	36.2	39.0	44.9
Bosch Ltd.	13.9	13.3	11.5	11.8	12.0
Exide Industries Ltd.	3.8	2.8	2.4	2.8	3.3
F A G Bearings India Ltd.	12.4	13.5	6.4	8.9	11.2
Motherson Sumi Systems Ltd.	16.0	15.6	11.2	8.4	12.3
Sundram Fasteners Ltd.	25.3	31.2	23.4	24.6	28.1
Wabco India Ltd.	2.9	6.8	8.2	11.5	12.5
Industry Total	**8.5**	**9.5**	**9.1**	**9.0**	**10.0**

Table 11.11 Descriptive statistics

	Mean	Standard deviation	Minimum	Maximum
Pharmaceutical industry				
Exports	9491.7	10644.6	144.5	54114.8
Sales	19773.6	16106.2	2379.0	76671.7
PAT	3854.5	12763.7	−30517.3	128969.1[a]
R&D	1001.5	1325.2	7.5	6221.0
Automobile industry				
Exports	9155.5	12374.3	186.3	64506.2
Sales	98433.0	124624.7	4114.2	591991.7
PAT	6991.2	8529.9	118.7	33397.3
R&D	870.7	1955.3	2.1	13711.6

[a]This abnormally high value is due to the profit reporting by Piramal Enterprises after the sell-out of its pharmaceutical formulations business to Abbot Laboratories

Sundaram Fasteners have recorded an export intensity of more than 20 % as against an industry average of 10 %.

Tables 11.11 and 11.12 present the descriptive statistics and regression results for both the pharmaceutical and automobile industries. The results for the pharmaceutical industry reveal that export sales are significantly and positively associated with both total sales and R&D, but

Table 11.12 Regression results

	Coefficients	t-stats	p-values
Pharmaceutical industry			
Intercept	−1445.89	−2.48	0.014
Sales	0.41	11.12	0.000
PAT	−0.02	−0.85	0.398
R&D	2.91	6.50	0.000
Adjusted R^2	*0.88*		
Automobile industry			
Intercept	−1288.46	1.08	0.283
Sales	0.03	1.73	0.087
PAT	0.62	3.21	0.002
R&D	0.40	0.50	0.617
Adjusted R^2	*0.55*		

not with profit after tax, after controlling for the other variables. In contrast, in the case of the automobile industry, the key driver of export sales appears to profit after tax, with marginal contribution from total sales and no significant contribution from R&D expenditures.

Conclusions

The increasing tendency toward a global economy and the severities of trade deficits are being experienced by many developing countries, such as India. In this scenario, firm characteristics and performance in export markets provide real potential for research. The findings of such studies can be of importance to both public- and private-sector administrators concerned with future export development and success. The present study is an attempt to examine the determinants of export performance of two key industries in India: pharmaceuticals and automobiles.

The findings of this study corroborate the findings of the previous studies, which report quite different results in different contexts. The results of this study can be used to further explore non-demographic variables that may affect export performance. Researchers may want to investigate the impact of R&D expenditure on the number of patents obtained by pharmaceutical and automobile companies, and explore the managerial and other organizational characteristics that affect firm-level export performance.

References

Automotive Component Manufacturers' Association (ACMA). (2011). *Auto component industry in India: Growing capabilities & strengths*. Available from: http://www.ibef.org/archives/detail/b3ZlcnZpZXcmMzMzNjMmOTE. Accessed 2 Jan 2013.

Banerji, A. (2012). A selective study of exports of manufactured goods from India: Auto parts and pharmaceuticals. *Journal of International Business Research, 11*(2), 89–117.

Calantone, R. J., Kim, D., Schmidt, J. B., & Cavusgil, S. T. (2006). The influence of internal and external firm factors on international product adaptation strategy and export performance: A three-country comparison. *Journal of Business Research, 59*, 176–185.

Cavusgil, S. T., & Zou, S. (1994). Marketing strategy-performance relationship: An investigation of the empirical link in export market ventures. *Journal of Marketing, 58*(1), 1–21.

Cooper, R. G., & Kleinschmidt, E. J. (1985). The impact of export strategy on export sales performance. *Journal of International Business Studies, 16*(1), 37–55.

Diamantopoulos, A., & Kakkos, N. (2007). Managerial assessments of export performance: Conceptual framework and empirical illustration. *Journal of International Marketing, 15*(3), 1–31.

Francis, J., & Collins-Dodd, C. (2000). The impact of firms' export orientation on the export performance of high-tech small and medium-sized enterprises. *Journal of International Marketing, 8*(3), 84–103.

Hoang, B. P. (1998). A causal study of relationships between firm characteristics, international marketing strategies, and export performance. *Management International Review, 38*, 73–93.

IMS Health. (2012). *IMS Health report*. Available from: http://www.ibef.org/archives/detail/b3ZlcnZpZXcmMzM0NjgmOTA. Accessed 13 Feb 2013.

Katsikeas, C. S., & Morgan, R. E. (1994). Differences in perceptions of exporting problems based on firm size and export market experience. *European Journal of Marketing, 28*(5), 17–35.

Katsikeas, C. S., Deng, S. L., & Wortzel, L. H. (1997). Perceived export success factors of small and medium-sized Canadian firms. *Journal of International Marketing, 5*(4), 53–72.

Leonidou, L. C., Katsikeas, C. S., & Samiee, S. (2002). Marketing strategy determinants of export performance: A meta-analysis. *Journal of Business Research, 55*, 51–67.

Pharmaceutical Exports Council of India (Pharmexcil). (2012). *Pharmaceutical Export Promotion Council of India report*. Available from: http://www.ibef.org/pages/33468. Accessed 13 Feb 2013.
Saranga, H. (2007). Multiple objective data envelopment analysis as applied to the Indian Pharmaceutical Industry. *Journal of the Operational Research Society, 58*, 1480–1493.
Serra, F., Pointon, J., & Abdou, H. (2012). Factors influencing the propensity to export: A study of UK and Portuguese textile firms. *International Business Review, 21*, 210–224.
Sousa, C. M. P. (2004). Export performance measurement: An evaluation of the empirical research in the literature. *Academy of Marketing Science Review, 9*, 1–22.
World Trade Organization. (2011). *International trade statistics 2011*. [Online] Available from: https://www.wto.org/english/res_e/statis_e/its2011_e/its2011_e.pdf

Part IV

Finance and Technology

12

FDI and Economic Growth Nexus for the Largest FDI Recipients in Asian Emerging Economies: A Panel Co-integration Analysis

Preeti Flora and Gaurav Agrawal

Introduction

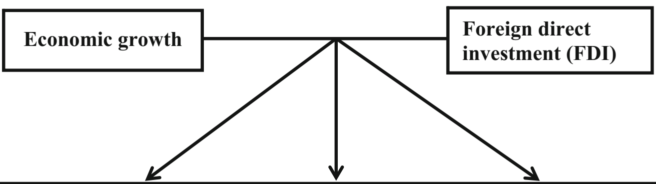
Foreign direct investment (FDI) inflows and outflows have substantial impact on the world economy, and are important for both developed and developing countries (e.g., Temiz & Gokmen, 2014). Foreign investments are generally assumed to have positive impacts on a country's economy, and to be among the principal factors supporting accelerated economic growth (Okamoto & Sjoholm, 2005). In the literature, among the most-cited reasons for Asia's strong economic growth in the recent era has been the inflow of FDI into the region. This inward FDI has also proven to be an effective means through which Asian countries are integrated with rest of the world (and vice-versa) (Vadlamannati, Tamazian, & Irala, 2009). Today, most countries are inclined to attract FDI, due to the expected favorable

P. Flora (✉) • G. Agrawal
ABV-Indian Institute of Information Technology and Management,
Gwalior, India
e-mail: preetiflora@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_12

effects on income generation from capital inflows, advanced technology, management skills, and market know-how. In developing countries, such as China and India, the attraction of foreign capital is considered to be a necessary means for economic growth (Choong & Lam, 2010; Kurtishi-Kastrati, 2013). It is widely recognized that FDI provides economic benefits to recipient countries by providing capital, foreign exchange, and technology, and by increasing both competition and access to foreign markets (e.g., Romer, 1993; World Bank, 1999; Crespo & Fontoura, 2007).

Studies on the nexus of FDI and economic growth over the years have generally focused on two approaches: the production function approach (e.g., Harms & Ursprung, 2004; Lipesy, 2000) and the time series approach (e.g., Pradhan, 2009; Nair-Reichert & Weinhold, 2001; Bahmani-Oskooee & Niroomand, 1999). This study focuses on the time series approach for investigating the relationship between inward FDI and economic growth. Figure 12.1 provides a brief insight into some of the key studies conducted exploring the FDI–economic growth nexus. It is worth noting that, to date, the empirical evidence regarding this relationship is mixed and inconclusive, and varies by the economies (in case of panel data) and the time periods considered (Flora & Agrawal, 2014).



Positive	Inconclusive	Negative
De Mello (1999), Nair-Reichert & Weinhold (2001), Campos & Kinoshita (2002), Alfaro et al. (2004), Basu et al. (2003), Lensink & Morrissey (2006), Ljunwal & Li (2007), Alguacil et al. (2011), Anwar & Cooray (2012), Roy & Mandal (2012), Gursoy & Kalyoncu (2012)	Ericsson & Irandoust (2001), Carkovic & Levine (2002, 2005), Zhang (2001), Hermes & Lensink (2003)	Saltz (1992), Bende- Nabende et al. (2000), Alfaro (2003), Mencinger (2003), Darrat et al. (2005), Ang (2009), Alfaro et al. (2010), Wang & Wong (2011)

Fig. 12.1 Empirical literature on FDI and economic growth nexus (*Source*: Compiled from Flora and Agrawal (2014))

Thus, the main objective of this study is to empirically investigate the relationship between FDI and economic growth in the group of Asian emerging or developing economies that have been receiving the highest FDI inflows. The study contributes to the existing literature on the nexus of FDI and economic growth by investigating a set of economies that are making strong contributions toward Asia's economic growth and development, by attracting huge amount of foreign investments during the last few decades.

Literature Review

The relationship between FDI and economic growth has motivated extensive empirical literature, focusing on both developed and developing countries. Studies conducted by Blomstrom, Lipsey, and Zejan (1992) and Borensztein, De Gregorio, and Lee (1998) found that FDI is positively related to a nation's economic growth. An economy with a positive and consistent growth over a period of years is more likely to attract investors, as compared to a slower growing or stagnant economy. Studies on the relationship between economic growth and capital formation have found that gross domestic investment influences a country's economic growth. Coe, Helpman, and Hoffmaister (1997) identified a positive association between FDI and economic growth, but suggested that host countries that have attained some level of development are more capable of reaping the benefits of higher productivity. Furthermore, Lui, Chow, and Li (2006) found evidence that higher economic growth attracts more FDI inflows. Khondoker (2007) investigated the relationship between FDI and economic growth, and indicated that developing countries can attract more FDI if they have higher economic growth rates and more investment-friendly policies. Another study, by Ljugwall and Li (2007), evaluated the relationship between FDI and economic growth, considering the role of the financial sector in China, and found a strongly significant positive relationship between FDI and economic growth; this result is similar to the findings of Hermes and Lensink (2003), Alfaro, Chanda, Kalemli-Ozcan, and Sayek (2004), and Krogstrup and Matar (2005). Liu, Burridge, and Sinclair (2002) tested for evidence of a long-run relationship among economic growth, FDI, and trade in China, using a co-integration methodology for the time period from 1981 to 1997, and found evidence of a bidirectional causal relationship among the variables. Hence, one can observe strong evidence of a bidirectional relationship between FDI inflows and economic growth rate.

However, there also exist contradictory theoretical perspectives, which predict FDI in the presence of pre-existing trade, price, financial, and other distortions will hurt resource allocation and, in turn, slow growth (e.g., Boyd & Smith, 1992; Zhang, 2001; Carkovic & Levine, 2005). Carkovic and Levine (2002) investigated the relationship between FDI and economic growth for sample of 72 countries, and concluded that FDI does not exert any independent influence on economic growth for either developed or developing countries. Nonnemberg and Mendonca (2004) found that strong GDP growth can induce FDI inflow, but that FDI does not necessarily induce economic growth. The authors used China as an example to demonstrate this point. China is obviously one of the world's largest developing economies, with among the highest rates of growth; this, in turn, ensures that China is also one of the largest recipients of FDI. Analyzing 39 Sub-Saharan African countries, Seetanah and Khadaroo (2007) found that, though the contribution of FDI is small when compared to other growth factors, it not only contributes to, but also follows from, economic growth. However, Duasa (2007) observed no causality between FDI and economic growth in Malaysia, but suggested that FDI does contribute to the stability of growth. In another study, Wang and Wong (2011) emphasized the distinction between cross-border mergers and acquisitions, which involve buying existing entities, and greenfield investments that entail starting up a new entity, and noted that these two forms of FDI are likely to have different effects on economic growth.

Hence, the extant literature provides evidence that the relationship between FDI and economic growth is nuanced and far from straightforward (Vu & Noy, 2009; Li & Liu, 2005), varying across economies and the time period considered for conducting the analysis. This chapter investigates the FDI–economic growth nexus in five key developing economies in Asia, using a time series approach. The methodology adopted for conducting this study follows the work done by Pradhan (2009) for testing the FDI-led growth hypothesis in ASEAN-5 economies, in which the empirical evidence was based on analysis at both panel and individual country level.

Methodology

Selection of Countries

Table 12.1 presents the total amount of FDI received by these five economies during the time frame under consideration, while Fig. 12.2 presents some regional comparisons. It is evident that countries in the Asian region receive substantial inward FDI, and that the East Asian region, dominated by China, has a major contribution to the overall regional FDI inflows. Thus, the Asian region represents an interesting context for this analysis. The countries selected for the study were identified on the basis of UNCTAD yearly *World Investment Report* (UNCTAD, 2011), which divides the Asian region into four parts: East (seven countries), West (13 countries), South (nine countries), and South East (12 countries).

The five countries selected were those that had received largest FDI inflows during the 1985–2011 period. China, the largest recipient in the East Asian region, was included, as was India, from the South Asian region. Three countries from the South East Asian region—Singapore, Thailand, and Malaysia—were also included. (While Saudi Arabia was the largest FDI recipient in the West Asian region, it was not included in the sample, in order to maintain the focus on the East, South, and South East regions, more traditionally viewed as "Asia".)

Table 12.1 Countries receiving highest FDI inflows in Asia

Region	Country	FDI inflows (1985–2011) (in US $)
East Asia	China[a]	1,228,669
	China, Hong Kong SAR	647,570
	Korea	101,037
South Asia	India[a]	228,910
	Pakistan	31,704
Southeast Asia	Singapore[a]	432,623
	Thailand[a]	120,020
	Malaysia[a]	115,208
	Indonesia	85,375

Source: Authors' calculation, based on UNCTAD Statistical Database
[a]Countries selected for analysis

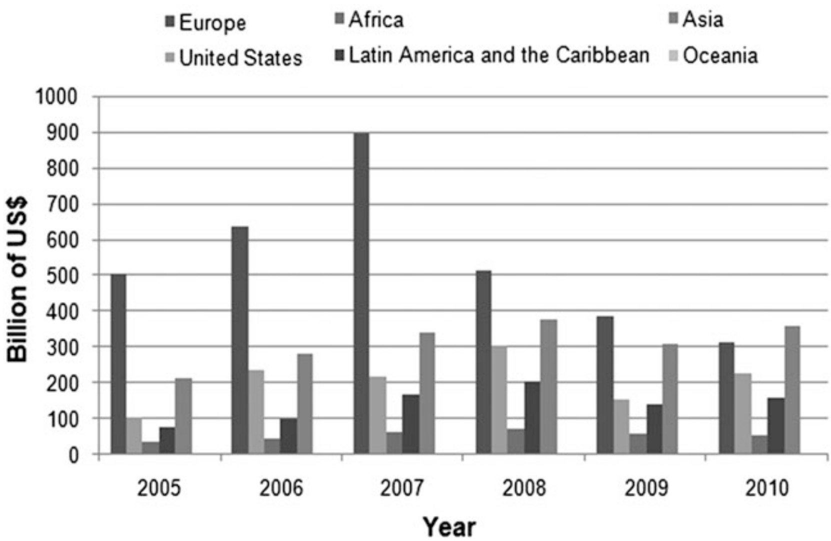


Fig. 12.2 FDI inflows in major regions
(*Source*: Compiled from UNCTAD, 2011)

Data

The study consists of a balanced panel of five countries (China, India, Malaysia, Singapore, and Thailand) over the period of 26 years (1985–2011). Two variables have been used for conducting the empirical investigation: annual inward foreign direct investment flows and Gross Domestic Product as the indicator for economic growth. The data used in the study are collected from the UNCTAD and World Bank statistical databases, and the analyses of stationarity, causality, and co-integration have been undertaken with the help of Eviews 7.0.

Econometric Approach

In order to investigate a long-run relationship between these variables, the first step involves checking the order of integration by applying unit root tests. A data series is said to be stationary if its mean and variance are constant over time, and the value of the covariance between two time periods depends only on the lag between the two time periods and not on the actual time at which the covariance is computed. Here, for the individual series, the Augmented Dickey Fuller (ADF) test (Dickey & Fuller, 1981) is used; for the panel data, the Levin–Lin–Chu (LLC) (Levin, Lin, & Chu, 2002) and Im–Pesaran–Shin (IPS) (Im, Pesaran, & Shin, 2003) tests are employed. The IPS test is considered to be one of the most powerful unit root tests. It is based on the heterogeneity of the autoregressive parameters, and is widely employed in the literature.

Next, the Pedroni and Johansen tests for co-integration are employed for the panel data and the individual level analyses, respectively. The Johansen test is a procedure for testing for co-integration between time series. This test has a number of desirable properties, including the fact that all test variables are treated as endogenous (Johansen & Juselius, 1990). The panel co-integration technique addresses this issue by allowing the pooling of information regarding common long-run relationships between a set of variables from individual members of a panel. Pedroni (1999) refers to seven different statistics for testing unit roots in the residuals of the postulated long-run relationship. Of these, the first four are referred to as "panel co-integration statistics", while the last three are known as "group mean panel co-integration statistics". In the presence of a co-integrating relation, the residuals are expected to be stationary. A positive value for the first statistic and large negative values for the remaining six statistics allow rejection of the null hypothesis.

Finally, the study investigates the causal relationship between FDI and economic growth, both at individual level, using pair-wise Granger causality analysis, and at panel level, using the VEC Granger causality/block exogeneity Wald test.

Results of the Analysis

Unit root testing of time series data is an important step to be undertaken ahead of the analyses of co-integration and causality, in order to ensure that the necessary conditions for the inference are satisfied. The results of the unit root testing are presented in Table 12.2, with panels (a) and (b) showing the results at the levels of the individual country and the full panel, respectively.

Table 12.2 Unit root test results **(a)** Individual sample (ADF Test), **(b)** Panel unit root test (summary)

	FDI		GDP		
	Level	First difference	Level	First difference	Order of integration
(a)					
China	1.98	−5.57*	4.21	−5.34*	**I (1)**
India	−0.75	−5.07*	0.79	−4.55*	**I (1)**
Malaysia	−1.85	−7.80*	0.51	−6.33*	**I (1)**
Thailand	−1.95	−7.39*	−0.59	−4.36*	**I (1)**
Singapore	0.07	−8.85*	−0.06	−4.15*	**I (1)**
(b)					
Levin, Lin & Chu	−2.15	−6.83*	3.60	−3.78*	**I (1)**
Im, Pesaran & Shin W-stat	0.29	−6.75*	4.79	−3.68*	**I (1)**

Note: *FDI* foreign direct investment, *GDP* economic growth (gross domestic product)
*$p < 0.01$

The ADF test has been applied to individual series, while LLC and IPS tests have been used for the panel of five countries (China, India, Indonesia, Thailand, and Malaysia). The results of these tests indicate that all of the time series variables used in the study have unit roots, indicating a lack of stationarity. The test statistics cannot lead to rejection of the null hypothesis of non-stationarity, at 1 % level of significance. However, they are stationary at the first difference level, as the null hypothesis of non-stationarity is rejected at 5 % level of significance. Because it can be inferred that the series is non-stationary but its first difference is stationary, the process is called "integrated of order 1", or simply "I(1)".

After confirming the existence of unit roots for all the data series considered for the study, the next step involves checking the possibility of the existence of a long-run relationship between FDI and economic growth. Here, we employ co-integration tests, at both the individual and the panel levels. Johansen's maximum likelihood co-integration test is applied for each country's data, whereas Pedroni's panel co-integration test is used for the five-country panel data. Table 12.3 reports the results of the co-integration tests, which indicate the presence of co-integration between economic growth and FDI in the panel of five Asian economies selected for the study. Analysis at the individual country level, though,

Table 12.3 Co-integration test results

(a): Johansen's co-integration test results
(Testing conducted for individual country-level data, in order to investigate the long-run relationship between FDI and GDP in these economies)

Countries	Null hypothesis	Trace statistics		Max. eigenvalue statistics	
		Statistics	*p* -value	Statistics	*p* -value
China	None	9.26	0.34	9.09	0.28
	At most one	0.17	0.68	0.17	0.68
India	None	30.2	**0.00**	30.19	**0.00**
	At most one	0.06	0.81	0.06	0.81
Malaysia	None	21.8	**0.00**	21.59	**0.00**
	At most one	0.2	0.65	0.2	0.65
Thailand	None	5.67	0.73	5.28	0.71
	At most one	0.4	0.53	0.4	0.53
Singapore	None	27.62	**0.00**	27.45	**0.00**
	At most one	0.17	0.68	0.17	0.68

(b): Pedroni's panel co-integration test results
(Testing conducted for group/panel-level data of all five countries, in order to investigate the long-run relationship between FDI and GDP)

	Statistics	*p* -value
Panel v-Statistic	1.95	**0.02**
Panel rho-Statistic	–3.47	**0.00**
Panel PP-Statistic	–2.60	**0.00**
Panel ADF-Statistic	–2.60	**0.00**
Group rho-Statistic	–1.59	**0.03**
Group PP-Statistic	–2.65	**0.00**
Group ADF-Statistic	–2.65	**0.00**

suggests that this result may be driven by the economies of China and Thailand, given the finding of no significant co-integration between FDI and economic growth for India, Malaysia, and Singapore.

These results suggest that there is a possibility of a causal relationship between FDI and economic growth in this set of five economies between 1986 and 2011. The finding of no significant co-integration between the two variables in the India, Malaysia, and Singapore does not necessarily mean the absence of causality, or any other relationship, in the short run. For countries whose economic growth and FDI do not move together in the long run (i.e., co-integration), it is important to remember that these two variables may still

Table 12.4 Causality test results

(a): Pair-wise Granger causality analysis
(***To investigate the causal relationship between GDP and FDI for individual countries***)

Country	Null hypothesis	F-statistic	*p*-value
China	GDP does not Granger Cause FDI	2.34	0.12
	FDI does not Granger Cause GDP	4.56	**0.02**
India	GDP does not Granger Cause FDI	31.62	**0.00**
	FDI does not Granger Cause GDP	7.70	**0.00**
Malaysia	GDP does not Granger Cause FDI	6.78	**0.00**
	FDI does not Granger Cause GDP	5.91	**0.01**
Singapore	GDP does not Granger Cause FDI	15.31	**0.00**
	FDI does not Granger Cause GDP	7.09	**0.00**
Thailand	GDP does not Granger Cause FDI	0.58	0.57
	FDI does not Granger Cause GDP	0.31	0.73

(b): VEC Granger causality/block exogeneity Wald tests
(***To investigate the causal relationship between GDP and FDI for the panel data of five countries***)

	GDP		FDI	
Dependent variable	**Chi-sq statistic**	***p*-value**	**Chi-sq statistic**	***p*-value**
FDI	27.89	**0.00**	–	–
GDP	–	–	24.52	**0.00**

(c): Summary of Granger causality results

Country	Granger causality relationships
	Individual pair-wise Granger causality
China	FDI ⟶ GDP
India	FDI ⟷ GDP
Malaysia	FDI ⟷ GDP
Singapore	FDI ⟷ GDP
Thailand	FDI ___ GDP
	VEC Granger causality
All	FDI ⟷ GDP

GDP gross domestic product, *FDI* foreign direct investment affect each other in the short run. To investigate this, we test for Granger causality, which is based on a specific definition of a causal relationship in time series data, using an error correction model (ECM) where we have found evidence of co-integration, and simple Granger causality where no significant co-integration has been identified, to understand the direction of any causality between FDI and economic growth in our sample. The use of the ECM allows for detection of both short- and long-run causal relationships.

Table 12.4 presents causality analysis results, at both individual and panel levels. The results at individual country level provide strong evidence of bidirectional Granger causality between FDI and economic growth in India, Malaysia, and Singapore between 1986 and 2011, which suggests the presence of a feedback mechanism between these two variables. These results drive the panel-level finding of bidirectional Granger causality. Evidence of unidirectional Granger causality is observed for the Chinese data, while the Thai data offer no evidence of a causal relationship.

Conclusion

The study investigates a key, but understudied, research area in international business: the FDI–economic growth nexus. Using annual data from 1985 to 2011 for Asian economies that are recipients of high FDI inflows in the recent past, we employ econometric time series methodologies to assess univariate- and panel-level co-integration and Granger causality. The findings suggest that inward FDI and economic growth share long-run relationships, or rather are integrated in the long run, at the group (panel) level, based on Pedroni's panel co-integration test results. However, analyzing the data from the individual economies, using Johansen's co-integration test, provides some more nuanced results. Similarly, assessment of Granger causality at the panel level provides evidence of bidirectional causality between FDI and economic growth, suggesting that increased FDI can help in inducing economic growth and development, and vice-versa. Despite the limitations associated with this analysis, including a limited sample size, the observed relationships between inward FDI and economic growth suggest that there may be real benefits for emerging and transition economy governments to enact policies that will serve to attract higher levels of foreign investment, as this may assist in more general economic growth.

References

Alfaro, L. (2003). *Foreign direct investment and growth: Does the sector matter?* Boston: Harvard Business Press.

Alfaro, L., Chanda, A., Kalemli-Ozcan, S., & Sayek, S. (2004). FDI and economic growth: The role of local financial markets. *Journal of International Economics, 64*, 113–134.

Alfaro, L., Chanda, A., Kalemli-Ozcan, S., & Sayek, S. (2010). Does foreign direct investment promote growth? Exploring the role of financial markets on linkages. *Journal of Development Economics, 91*, 242–256.

Alguacil, M., Cuadros, A., & Orts, V. (2011). Inward FDI and growth: The role of macroeconomic and institutional environment. *Journal of Policy Modeling, 33*, 481–496.

Ang, J. B. (2009). Foreign direct investment and its impact on the Thai economy: The role of financial development. *Journal of Economics and Finance, 33*, 316–323.

Anwar, S., & Cooray, A. (2012). Financial development, political rights, civil liberties and economic growth: Evidence from South Asia. *Economic Modelling, 29*, 974–981.

Bahmani-Oskooee, M., & Niroomand, F. (1999). Openness and economic growth: An empirical investigation. *Applied Economics Letters, 6*, 557–561.

Basu, P., Chakraborty, C., & Reagle, D. (2003). Liberalization, FDI, and growth in developing countries: A panel cointegration approach. *Economic Inquiry, 41*, 510–516.

Bende-Nabende, A., Ford, J. L., Sen, S., & Slater J. (2000). *Long-run dynamics of FDI and its spillovers onto output: Evidence from the Asia-Pacific Economic Cooperation region* (University of Birmingham Department of Economics discussion paper, 1–10). Birmingham: University of Birmingham.

Blomstrom, M., Lipsey, R., & Zejan, M. (1992). *What explains developing country growth?* (NBER working paper No. 4132). Cambridge, MA: NBER.

Borensztein, E., De Gregorio, J., & Lee, J. W. (1998). How does foreign direct investment affect growth? *Journal of International Economics, 45*, 115–135.

Boyd, J. H., & Smith, B. D. (1992). Intermediation and the equilibrium allocation of investment capital: Implications for economic development. *Journal of Monetary Economics, 30*, 409–432.

Campos, N. F., & Kinoshita, Y. (2002). Foreign direct investment as technology transferred: Some panel evidence from the transition economies. *The Manchester School, 70*, 398–419. doi:10.1111/1467-9957.00309.

Carkovic, M., & Levine, R. (2002). *Does foreign direct investment accelerate economic growth?* (University of Minnesota Department of Finance working paper). Available at SSRN:http://ssrn.com/abstract=314924 or http://dx.doi.org/10.2139/ssrn.314924

Carkovic, M., & Levine, R. (2005). Does foreign direct investment accelerate economic growth? In T. H. Moran, E. D. Graham, & M. Blomstrom (Eds.), *Does foreign direct investment promote development?* (pp. 195–220). Washington, DC: Institute of International Economics.

Choong, C., & Lam, S. (2010). The determinants of foreign direct investment in Malaysia: A revisit. *Global Economic Review, 39*(2), 175–195.

Coe, D. T., Helpman, E., & Hoffmaister, A. W. (1997). North–South R&D spillovers. *Economic Journal, 107*, 134–149.

Crespo, N., & Fontoura, M. P. (2007). Determinant factors of FDI spillovers – what do we really know? *World Development, 35*, 410–425.

Darrat, A. F., Kherfi, S., & Soliman, S. (2005). FDI and economic growth in CEE and MENA countries: A tale of two regions. In *Economic Research Forum, 12th annual conference, 19th–21st December 2005, Cairo, Egypt*.

De Mello, L. R. (1999). Foreign direct investment led growth: Evidence from time series and panel data. *Oxford Economic Papers, 51*, 133–151.

Dickey, D. A., & Fuller, W. A. (1981). Distribution of the estimators for autoregressive time series with a unit root. *Econometrica, 49*, 1057–1072.

Duasa, J. (2007). Malaysian foreign direct investment and growth: Does stability matter? *Journal of Economic Cooperation, 28*, 83–98.

Ericsson, J., & Irandoust, M. (2001). On the causality between foreign direct investment and output: A comparative study. *The International Trade Journal, 15*(1), 1–26.

Flora, P., & Agrawal, G. (2014). FDI and economic growth relationship among highest FDI recipient Asian emerging economies: A panel data analysis. *International Business Management, 8*, 126–132.

Gursoy, F., & Kalyoncu, H. (2012). Foreign direct investment and growth relationship in Georgia. *International Journal of Economics and Financial Issues, 2*(3), 267–271.

Harms, P., & Ursprung, H. W. (2004). Do civil and political repression really boost FDI? *Economic Inquiry, 40*, 651–663.

Hermes, N., & Lensink, R. (2003). Foreign direct investment, financial development and economic growth. *Journal of Development Studies, 40*, 142–163.

Im, K., Pesaran, M. H., & Shin, Y. (2003). Testing for unit roots in heterogeneous panels. *Journal of Econometrics, 115*(1), 53–74.

Johansen, S., & Juselius, K. (1990). Maximum likelihood estimation and inference on co-integration with application to the demand of money. *Oxford Bulletin of Economics and Statistics, 52*, 169–210.

Khondoker, A. M. (2007). *Determinants of foreign direct investment and its impact on economic growth in developing countries* (MPRA paper No. 9457). Available from: http://www.mpra.ub.uni-muenchen.de/9457/. Posted 05, July 2008/20:27.

Krogstrup, S., & Matar, L. (2005). *Foreign direct investment, absorptive capacity and growth in Arab countries* (HEI working paper, 2005).

Kurtishi-Kastrati, S. (2013). The effects of foreign direct investments for host country's economy. *European Journal of Interdisciplinary Studies, 5*(1), 26–38.

Lensink, R., & Morrissey, O. (2001). *Foreign direct investment: Flows, volatility and growth in developing countries* (SOM research report 01E16). Groningen: SOM Research School, University of Groningen.

Levin, A., Lin, C. F., & Chu, C. S. J. (2002). Unit root tests in panel data: Asymptotic and finite-sample properties. *Journal of Econometrics, 108*, 1–24.

Li, X., & Liu, X. (2005). Foreign direct investment and economic growth: An increasingly endogenous relationship. *World Development, 33*, 393–408.

Lipesy, E. R. (2000). Inward foreign direct investment and economic growth in developing countries. *Transitional Corporations, 9*, 67–95.

Liu, X., Burridge, P., & Sinclair, P. J. N. (2002). Relationships between economic growth and foreign direct investment and trade: Evidence from China. *Applied Economics, 34*, 1433–1440.

Ljugwall, C., & Li, J. (2007). *Financial sector development, FDI and economic growth in China* (OCER Working Paper-E2007005). Beijing: Peking University.

Lui, L. G., Chow, K., & Li, U. (2006). Determinants of foreign direct investment in East Asia: Did China crowd out FDI from her developing East ASEAN neighbors? Hong Kong Monetary Authority, Research Memorandum 17/2006 November 2006, 1–23.

Mencinger, J. (2003). Does foreign direct investment always enhance economic growth? *Kyklos, 56*(4), 491–509.

Nair-Reichert, U., & Weinhold, D. (2001). Causality tests for cross country panels: New look at FDI and economic growth in developing countries. *Oxford Bulletin of Economics and Statistics, 63*, 153–171.

Nonnemberg, M. B., & Cardoso De Mendonca, M. J. (2004). The determinants of foreign direct investment in developing countries. In *Proceedings of the 32th Brazilian Economics Meeting, Brazil*.

Okamoto, Y., & Sjoholm, F. (2005). FDI and the dynamics of productivity in Indonesian manufacturing. *Journal of Development Studies, 41*, 160–182.
Pedroni, P. (1999). Critical values for co-integration tests in heterogeneous panels with multiple regressors. *Oxford Bulletin of Economics and Statistics, 61*(Supplement 1), 653–670.
Pradhan, R. P. (2009). The FDI-led growth hypothesis in ASEAN-5 countries: Evidence from co integrated panel analysis. *International Journal of Business and Management, 4*(12), 153–164.
Romer, P. (1993). Idea gaps and object gaps in economic development. *Journal of Monetary Economics, 32*(3), 543–573.
Roy, S., & Mandal, K. K. (2012). Foreign direct investment and economic growth: Analysis for selected Asian countries. *Journal of Business Studies Quarterly, 4*(1), 15–24.
Saltz, I. (1992). The negative correlation between foreign direct investment and economic growth in the third world: Theory and evidence. *Rivista Internazionale di Scienze Economiche e Commerciali, 39*, 617–633.
Seetanah, B., & Khadaroo, A. J. (2007). Foreign direct investment and growth: New evidence from Sub-Saharan African countries. University of Mauritius, 1–27.
Temiz, D., & Gokmen, A. (2014). FDI inflow as an international business operation by MNCs and economic growth: An empirical study on Turkey. *International Business Review, 23*, 145–154.
UNCTAD. (2011). *World investment report: Non equity modes of international production and development*. Geneva: United Nations Conference on Trade And Development, 251 pages.
Vadlamannati, K. C., Tamazian, A., & Irala, L. R. (2009). Determinants of foreign direct investment and volatility in South East Asian economies. *Journal of the Asia Pacific Economy, 14*, 246–261.
Vu, T. B., & Noy, I. (2009). Sectoral analysis of foreign direct investment and growth in the developed countries. *Journal of International Financial Markets, Institutions & Money, 19*, 402–413.
Wang, M., & Wong, M. C. S. (2011). FDI, education, and economic growth: Quality matters. *Atlantic Economic Journal, 39*, 103–116.
World Bank. (1999). *Foreign direct investment in Bangladesh: Issues of long-run sustainability*. Dhaka, Bangladesh: Bangladesh Country Office.
Zhang, K. H. (2001). Does foreign direct investment promote economic growth? Evidence from East Asia and Latin America. *Contemporary Economic Policy, 19*, 175–185.

13

Global Financial Markets Integration: A Comparative Study Between Developed and Emerging Economies

Gaurav Agrawal

Introduction

Co-integration of global financial markets has turned out to be an appealing research issue after global financial crisis of 2007–2008. Co-integration of global financial markets is a frequently researched phenomenon in the finance and economics literature. Most of the existing research work in market co-integration commonly used time series techniques to find out short-run and long-run relation among different financial time series. In 2007–2008, the world had seen drastic changes in the financial status of various economies. These drastic changes have been reflected due to the occurrence of various series of events starting with real estate bubble in the USA in 2007, Lehman brothers' bankruptcy in 2008, and many other such events consecutively. These series of events resulted in a sharp drop in international trade, rising unemployment,

G. Agrawal (✉)
ABV-Indian Institute of Information Technology and Management,
Gwalior, India
e-mail: drgauravagrawal@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_13

and depreciating commodity prices. Markets across the world, which were going through bull phases, gradually began to fall down. Almost all indices have shown a negative performance during 2007–2008. It is a well-established fact that the performance of all the world stock markets is directly responsible for a significant amount of the world's economic condition. In general stock market growth is a leading indicator that the state of an economy is flourishing, while declining trends indicate economic slowdown. Since stock markets are primarily based on investors' confidence, the impact of such events becomes a prime factor which cannot be undermined while determining their performance. While stock markets reveal the economic state of the respective nations, their impact has been growing tremendously across national boundaries with the advent of globalization and liberalization, thereby making the co-integration among markets across the world imperative. Thus, this increased interdependency among markets has led to a global impact of the above events, causing Global Financial Crisis (GFC). Thus, this stock market co-integration plays a major role, especially during these times of crises. The concept of stock market integration focuses on the idea that economies can integrate among themselves through the use of the marketplace. Though this integration has given vast diversification for the investors, it has also introduced the factor of risk, due to which any major event is presumed to have a global impact. It is during a crisis in the financial markets that the importance of integration is highlighted. While there might be different factors which could affect economies worldwide, integration among these economies considerably amplifies the impact that they could possibly create. Thus, we see that integration among economies has its own pros and cons depending on the situation. Considering the pivotal role that stock market integration plays in the world of markets, this chapter attempts to study co-integration among different economies and how the degree of co-integration varies in times of global events. This could provide an insight as to how different markets react to global crisis nowadays and might be helpful in providing scope for further work in what could be done to mitigate the undesirable effects of integration. The integration among economies has been found to vary from time to time and also the extent or degree to which integration exists fluctuates.

Hence, it becomes important for us to select the time during which we plan to conduct the study. This chapter analyzes whether the patterns of global market integration have changed because of the financial crisis of 2007–2008. Our data set consists of ten market indices from three major continents around the world considering three phases during the period of 2005–2011.

Literature Review

Several studies from all around the world were conducted at different times to study the co-integration between different countries. Some of them are: Yang, Kolari and Min (2003) studied the degree to which the five stock markets in the original ASEAN countries (ASEAN-5) are correlated as a way to assess the feasibility of ASEAN stock market integration and the implications for portfolio investors using the time series technique of co-integration to extract a long-run relation. The empirical results suggest that the ASEAN-5 stock markets are co-integrated and are thus not completely segmented by national borders. Ng (2002) applied Johansen's approach to five Asian economies (Indonesia, Malaysia, Philippines, Singapore, and Thailand) for the pre-Asian crisis period between 1988 and 1997 and did not find a co-integration relationship. Kaltenhaeuser (2003) within a two-step GARCH framework explored the linkages between equity returns of ten sectors in the euro area, the USA and Japan, respectively. Using daily data from the period between January 1986 and October 2002, it has been found that during the late 1990s, price innovations in European equities (both aggregate returns and sector returns) have doubled or tripled their impact on other stock markets and that sectors have become more heterogeneous in each of the three currency areas. Reid and Plummer (2003) examined long-run relationships and short-run dynamic causal linkages among the US, Japanese, and ten Asian emerging stock markets, with particular attention to the 1997–1998 Asian Financial Crisis. Comparative analyses of pre-crisis, crisis, and post-crisis periods are conducted to comprehensively evaluate how stock market integration is affected by financial crises. The results for the case of Asia show that both long-run co-integration relationships and short-run causal linkages among these markets were strengthened during the crisis and that these markets have generally been more integrated after the crisis than before the crisis. An important implication in their findings is that the degree of integration among countries tends to change over time, especially around periods marked by financial crises. Veraros, Kasimati, and Dawson (2004), through an event study methodology, studied the effect of the nomination of Athens as the hosting city for the Olympics of 2004 on the stock exchanges of Greece (winner) and Italy (loser). This study reveals a significantly positive effect on the Athens Stock Exchange as a whole, as well as on infrastructure-related industries. No significant effect was identified on the Milan Stock Exchange. Hon, Strauss, and Yong (2004) using stock prices from 25 economies, tested whether the terrorist attack in the USA on September 11, 2001, resulted in a contagion—an increase in correlation across global financial markets. They modeled the intrinsic heteroscedasticity. The results indicate that international stock markets, particularly in Europe, responded more closely to US stock market shocks in the three to six months after the crisis than before and suggest that the benefits of international diversification in times of crisis are substantially diminished. Marashdeh (2005) studied financial integration among four emerging stock markets in the Middle East and North African (MENA) region and examined the integration between these markets and developed markets represented by the USA, UK, and Germany. It utilized the newly proposed autoregressive distributed lag approach to co-integration. The results show evidence of the existence of integration among stock markets in the MENA region, but not between the MENA markets and developed markets. Bertrand and Michel (2005) in their paper proposed the related index of market shocks. Hayo and Kutan (2005) analyzed the impact of news, oil prices, and international financial market developments on daily returns on Russian bond and stock markets. They also tested the degree of integration of Russian financial markets into the world markets. Thomas and Brian (2007) studied capital market integration in MENA countries and its implications for international portfolio investment allocation. Starting with four co-integration methodologies, they significantly rejected the hypothesis of a stable, long-run bivariate relationship between each of these markets and the European Monetary Union, the USA, and a regional benchmark. Finally, after adjusting the integration levels by relative market capitalization, Israel and Turkey are found to be the most promising markets in the region, followed by Egypt, Jordan, and Morocco while Tunisia and Lebanon seem to be lagging behind. They applied this measure on the French and the American stock markets to put large market events into perspective. Egert and Kocenda (2007) analyzed the movements among three stock markets in Central and Eastern Europe and, in addition, interdependence that may exist between Western Europe and Central and Eastern European stock markets. No robust co-integration relationship was found for any of the stock index pairs or for any of the extended specifications. Mukherjee and Mishra (2007) studied the International Stock Market Integration and the determinants of the integration with respect to the Indian Stock Market and the other World Equity markets. The sample size was of 16 years from July 1990 to December 2005. They found the existence of co-integration between India and the other 22 countries and used pooled regression model to find the determinants of the co-integration. Mukherjee and Mishra (2008) studied the return and volatility spillover among Indian stock market with that of 12 other developed and emerging Asian countries over a period from November 1997 to April 2008. The result found was that apart from different degrees of correlations, both in terms of return and squared return series, among Indian stock market with that of other Asian countries, the contemporaneous intraday return spillover among India and almost all the sample countries are found to be positively significant and bidirectional. Raj and Dal (2008) used Johansen Test over a period of 1993–2008: Phase I; April 1993–March 2003 and Phase II; April 2003–March 2008. The VECM and the Johansen co-integration test are used to find the co-integration and the study says the Indian stock market provides higher returns as compared to the other regional and world stock markets. The study also says that there is a differential impact on the Indian stock market both in long run and in short run. Bardhan, Edelstein, and Tsang (2008) used a set of multifactor models for annual data for 946 firms from 16 countries over the sample period, 1995–2002 and estimated the impact of a country's economic openness on returns of publicly traded real estate firms, controlling for the effects of global capital markets, domestic macroeconomic conditions and firm-specific variables. They found that a country's real estate security excess (risk-adjusted) returns are negatively related to its openness. Lim, Brooks, and Kim (2008) investigated the effects of the 1997 financial crisis on the efficiency of eight Asian stock markets on a country-by-country basis; the results of the study demonstrate that the crisis adversely affected the efficiency of most of the Asian stock markets, with Hong Kong being the hardest hit, followed by the Philippines, Malaysia, Singapore, Thailand, and Korea. However, most of these markets recovered in the post-crisis period in terms of improved market efficiency. Awokuse, Chopra, and Bessler (2009) showed evidence that the number of co-integrating vectors increases in the post-crisis period among 11 Asian economies. Rim and Setaputra (2010) analyzed dynamics of inter-market relationships between financial markets in the USA and ASEAN-5 countries by using daily MSCI returns for a period of 1992–2006. Their findings concluded that, the US influence remained strong in ASEAN markets for this period; the integration between the US and ASEAN markets and among ASEAN markets had not increased, also there was no interaction between ASEAN markets. Results of their research work suggest that ASEAN markets were not strongly integrated; there still exist many diversification benefits to be exploited in this region, and investors need to consider investing in these small, open, and developing markets to take advantage of diversification benefits. In a recent study conducted Shiok, Sheue, and Chong (2012) examined the existence of long-run co-integration relationship for Malaysian stock and bond market indices in the period surrounding the Asian financial crisis based on the Breitung rank test and Johansen co-integration test. The above literature review indicates that most of the study done so far had been only to investigate the existence of co-integration for a longer or shorter period between major stock markets. This chapter makes an attempt to compare the co-integration patterns both for longer and shorter time period by considering four different phases around the global financial crisis.

Data

The study of co-integration of stock markets is essential because it is a direct consequence of globalization and it has important implications for investors. The data used for analysis are collected from Yahoo finance for stock indices of various stock markets all over the world (www.yahoofinance.com). In order to find the co-integration between the markets, ten major indices have been selected in order to cover all the major economic continents and major markets in the corresponding continents. In the economic world, Europe, USA, and Asia play leading roles having large trading volumes and bigger stock markets. Thus, this study is concentrated mainly on the stock market indices of major continents. In this study, CAC (French Stock Exchange) and FTSE (share index of 100 UK companies listed on London stock Exchange) from Europe have been included. In Asia, BSE (India), NIKKEI (Japan), Shanghai Composite (China), and HSI (China) have been included since they are the major market exchanges in Asia and list large number of companies in their corresponding countries. In a similar fashion for USA, high volume traders like NASDAQ, NYSE, and major exchanges like S&P (index of 60 largest countries on Toronto Stock market exchange, Canada), DJIA which trade high volumes as well as include many major companies in the USA have been considered for the study. The data used for analysis are selected around the GFC from 2005 to 2011. Three different phases around the GFC were taken by considering the period from August 1, 2005 to February 28, 2007 (Phase I), August 1, 2007 to February 27, 2009 (Phase II), and August 3, 2009 to July 5, 2011 (Phase III). These three phases were selected in order to find whether GFC has changed the level or pattern of co-integration among the various markets considered for the study. Phase I is taken in order to evaluate the pre-crisis scenario, Phase II considers the starting and peak of the GFC and Phase III data are during the recovery after GFC. Table 13.1 shows the various stock indices that have been included in the present study. The stock prices used are the average closing price of the particular index. Prices of various indices are matched by calendar date and it is assumed that timing differences do not add any value in the trading sessions by considering real trading time for various stock markets under study.

Table 13.1 Stock markets and indices

Number	Country	Name	Index	Symbol in Yahoo Finance
1	India	Bombay SENSEX	BSE 30	^BSESN
2	France	Euronext Paris	CAC 40	^FCHI
3	USA	Dow Jones	DJIA	^DJI
4	UK	London Stock Exchange	FTSE 100	^FTSE
5	China	Hong Kong Exchange	HSI/HKSE	^HSI
6	USA	American Stock Exchange	NASDAQ	^IXIC
7	Japan	Tokyo Stock Exchange	NIKKEI 225	^N225
8	USA	New York Stock Exchange	NYSE	^NYA
9	USA	S&P 500	S&P 500	^GSPC
10	China	Shanghai Composite	SSEC	000001.SS

Methodology

This study considers closing prices of all indices. Instead of original closing prices, natural logarithmic values of these prices have been considered for easy computation and interpretation. The methods applied under study are: JB test to check normal distribution, pair-wise correlation among the indices, unit root tests like Augmented Dickey–Fuller (ADF) Test and Phillips-Perron (PP) Test to check stationarity, and Johansen co-integration test for finding out the long-run relationship among the various indices. The findings of stationary, correlation, and co-integration tests have been computed with the help of Eviews 7.0.

Normality Test

The Jarque-Bera (JB) test is used to test whether closing values of stock market indices considered follow the normal probability distribution. The JB test of normality is an asymptotic or large-sample test. This test computes the skewness and kurtosis measures and uses the following test statistic:

$$\mathrm{JB} = n\left[S^2/6 + (K-3)^2/24\right]$$

where, n = sample size, S = skewness coefficient, and K = kurtosis coefficient. For a normally distributed variable, S = 0 and K = 3. Therefore, the JB test of normality is a test of the joint hypothesis that S and K are 0 and 3, respectively.

Correlation

Correlation analysis helps in measuring the strength or degree of linear association between two variables. The correlation coefficient measures this strength of linear association. Mathematically, given any two X values, X_i and $X_{j,}$ the correlation between any two disturbances u_i and u_j is determined by calculating their covariance.

$$\operatorname{cov}\left(u_i, u_j \mid X_i, X_j\right) = \mathrm{E}\left\{\left[u_i - \mathrm{E}\left(u_i\right)\right] \mid X_i \left\{\left[u_j - \mathrm{E}\left(u_j\right)\right] \mid X_j\right\}\right.$$

$$\rho = \operatorname{cov}\left(X_i, X_j\right) / \operatorname{sqrt}(\operatorname{var}\left(X_i\right) * \operatorname{var}\left(X_j\right)$$

where i and j are for two different observations, cov denotes covariance, var denotes variance, sqrt refers to square root and ρ denotes correlation coefficient. The two observations are said to be serially correlated if the covariance calculated is not zero, else they are said to be not correlated. If the coefficient is positive then they are said to be positively correlated, else negatively correlated.

Unit Root Tests

A data series is said to be stationary if its mean and variance are constant (non-changing) over time and the value of covariance between two time periods depends only on the distance or lag between the two time periods and not on the actual time at which the covariance is computed. Two unit root tests have been applied to test whether a series is stationary or not. Stationarity condition has been tested using ADF and PP tests.

Augmented Dickey–Fuller Test

An ADF test is a version of the Dickey–Fuller test for a larger and more complicated set of time series models. This test is conducted by augmenting the preceding values of the dependent variable. ADF test consists of estimating the following regression:

$$\Delta y_t = \alpha + \ddot{u}_t + \hat{U} y_{t-1} + \delta_1 \Delta y_{t-1} + \ldots\ldots + \delta_p \Delta y_{t-p} + \epsilon_t$$

where α is a constant, $\ddot{u}$ is the coefficient on a general time and p is the lag order of the auto regressive process, and ϵ_t is a pure noise error. The number of lagged difference terms to include is often determined empirically, the idea being to include enough terms so that the error terms are serially uncorrelated.

Phillips-Perron (PP-Test)

An important assumption of the Dickey–Fuller test is that the error terms are independently and identically distributed. The ADF test adjusts the Dickey–Fuller test to take care of possible serial correlation in the error terms by adding the lagged difference terms of the regressand. In this test, non-parametric statistical methods are used to take care of the serial correlation in the error terms without adding lagged difference terms.

$$\Delta Y_t = \alpha + \ddot{u}\ Y_{t-1} + \epsilon_t$$

where α is a constant, $\ddot{u}$ is the coefficient on a general time, and ϵ_t is a pure noise error.

Co-integration Test

Over a long run, the relationship between one or more variables is determined by the term co-integration. When two or more series, integrated of order 1, after forming a linear combination exhibit stationarity, then they are said to be co-integrated. This co-integration can be tested by forming a regression equation or with the help of vector auto regression (VAR). Johansen test is used for testing this co-integration using VAR. Mathematically, co-integration can be shown as:

$$Y_t = \ddot{u}_1 + \ddot{u}_2 X_{2t} + \ddot{u}_3 X_{3t} + \ldots\ldots\ldots + \ddot{u}_k X_{kt} + u_t$$

where u_t (residual of the combination) should be $I(0)$, if the variables/series Y_t, X_{2t}, …, X_{kt} are co-integrated but it will be non-stationary if they are not.

Johansen Co-integration Test

Johansen test is a procedure for testing co-integration of several time series. This test does not require all variables to be in the same order of integration, and hence this test is much more convenient than the Engle–Granger test for unit roots which is based on the Dickey–Fuller test. Johansen's test has a number of desirable properties, including the fact that all test variables are treated as endogenous variables. This test is based on VAR model, mathematically shown as below:

$$Y_t = \ddot{u}_1 Y_{t-1} + \ddot{u}_2 Y_{t-2} + \ddot{u}_3 Y_{t-3} + \ldots\ldots\ldots + \ddot{u}_k Y_{t-k} + u_t$$

In order to use the Johansen test, the VAR above needs to be turned into a vector error correction model of the form:

$$\Delta Y_t = \prod Y_{t-k} + \Gamma_1 \Delta Y_{t-1} + \Gamma_2 \Delta Y_{t-2} + \ldots + \Gamma_{k-1} \Delta Y_{t-(k-1)} + u_t$$

where $\prod = (\,\Sigma\,(i = 1 \text{ to } n)\ \ddot{u}_i\,) - I_g$ and $\Gamma_i = (\,\Sigma\,(j = 1 \text{ to } i)\ \ddot{u}_j\,) - I_g$

where $\prod$ and Γ are long-run coefficient matrices.

There are two test statistics for co-integration under Johansen approach. They are: Trace Statistic and Maximum Eigen Value Statistic.

Trace Statistic

Null Hypothesis: Number of co-integrating vectors is less than or equal to r against an alternative of more than r.

$$\lambda_{trace}(r) = -T \Sigma \text{ (i=r+1 to g) } \ln(1-\lambda''_i)$$

where r is the number of co-integrating vectors under the null hypothesis. λ'_i is the estimated value for the ith ordered eigen value.

Maximum Eigen Value Statistic

Null Hypothesis: Number of co-integrating vectors is r against an alternative of $r+1$.

$$\lambda_{max}(r,r+1) = -T \ln(1-\lambda''_{r+1})$$

Analysis

Table 13.1 gives the list of ten indices considered for the study. Figures 13.1, 13.2, and 13.3 give the graphical plot representation of the closing price values and corresponding dates of the ten indices. Bull and Bear phases can easily be identified looking at the graphs. The descriptive statistics (Table 13.2) of four time periods considered show the values of skewness, kurtosis, and JB test results; it could be concluded that the closing price values of all the indices in all the three phases are not normally distributed. Pair-wise correlations of all the indices in the four phases are shown in Table 13.3. The values are displayed in a matrix form. These values denote that there exists high degree of correlation between the indices during first two phases of the data; however, it is observed that during the third phase (i.e., the recovery period) few indices, namely NIKKEI, Shanghai Stock Exchange composite (SSEC), and HIS, showed different correlation pattern with other indices. This leads

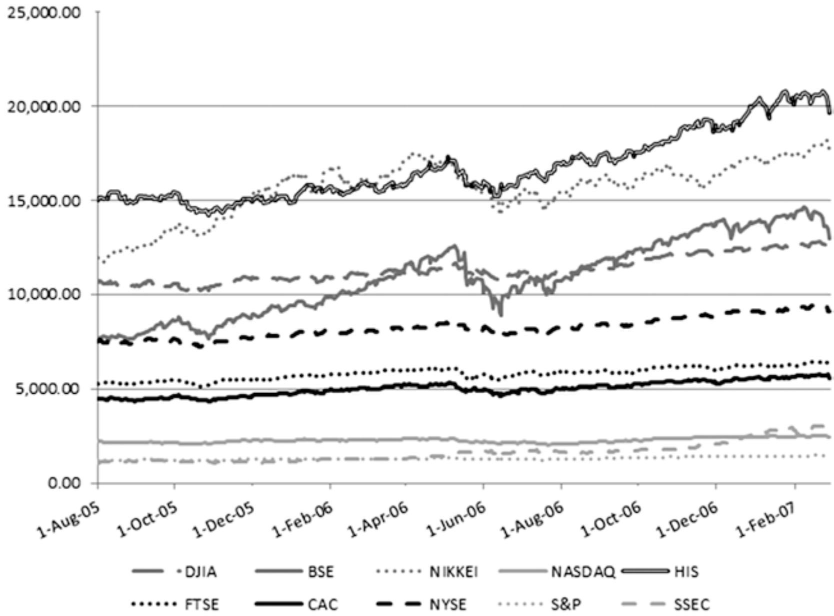


Fig. 13.1 Phase I

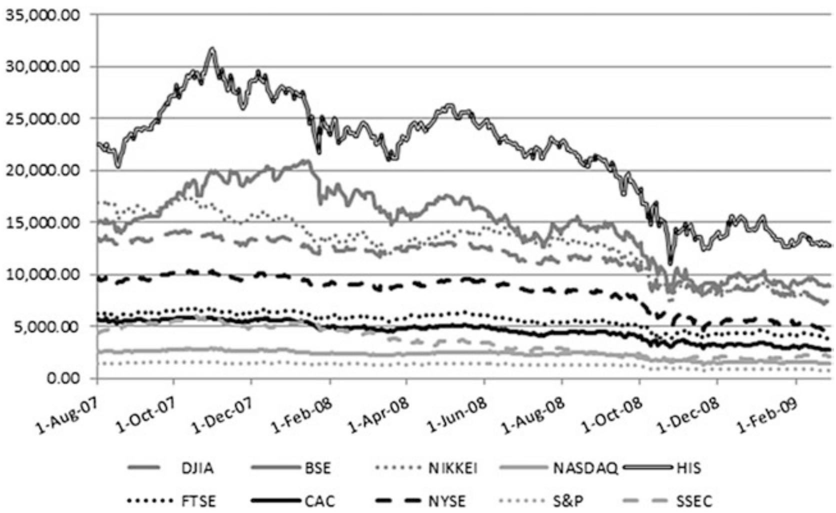


Fig. 13.2 Phase II

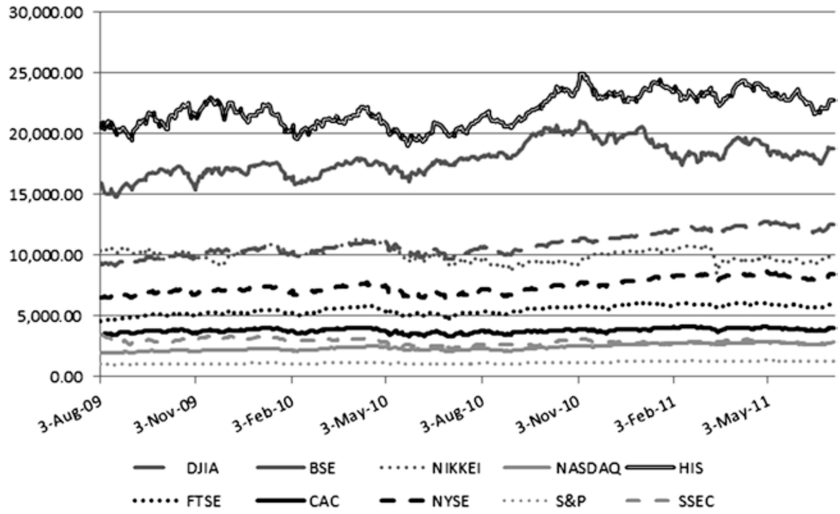


Fig. 13.3 Phase III

to the conclusion that these financial markets were interdependent on each other during the bull (Phase I) and bear phase (Phase II). It can also be seen that China's SSEC shows the weakest correlation almost with all other indices in Phase II and Phase III, thus giving a picture that it is not well correlated with markets when they are going down. It is observed that the Indian stock market was well correlated with France, the USA, and other major stock markets in the world during Phase I and Phase II. The study is further extended for long-run relationship, with the help of tests for co-integration. Each series is to be tested for stationarity before performing co-integration tests. Thus, unit root tests namely ADF and PP tests were conducted for checking the stationarity of the data. Tables 13.4 and 13.5 show the findings of ADF test and PP test respectively, performed on these indices. The main hypothesis for these stationarity tests is: the series is non-stationary. Observing the values at level 0, all the statistic values are lesser in magnitude than the critical values in both the phases. Thus, our hypothesis that the series is non-stationary couldn't be rejected. At level-1, all the values are much more negative compared to critical values at all levels of confidence; thus the hypothesis can be rejected, leading to the conclusion that all the indices

Table 13.2 Descriptive statistics

	Mean	Median	Max.	Min.	Std. dev.	Skewness	Kur-tosis	JB (all $p<0.05$)
Phase I								
BSE	10,876.7	10,768.0	14,652.1	7595.6	2016.7	0.1	1.9	22.0
CAC	5004.1	4999.4	5736.5	4326.7	378.2	0.1	2.0	17.0
DJIA	11,301.8	11,125.7	12,786.6	10,215.2	685.7	0.6	2.3	33.4
FTSE	5817.3	5855.9	6444.4	5142.1	317.4	–0.2	2.0	16.9
HSI	16,704.0	16,063.7	20,821.0	14,215.8	1778.0	0.8	2.6	47.9
NASDAQ	2257.4	2255.8	2524.9	2020.4	124.3	0.2	2.1	17.0
NIKKEI	15,597.8	15,915.6	18,215.4	11,766.5	1491.2	–0.8	2.9	44.4
NYSE	8229.3	8176.0	9453.9	7234.1	561.3	0.4	2.3	17.2
S&P	1300.4	1285.0	1459.7	1176.8	71.4	0.6	2.4	30.9
SSEC	1605.3	1545.6	3040.6	1079.2	514.2	1.3	3.8	118.0
Phase II								
BSE	14,768.2	15,200.9	20,873.3	8451.0	3585.9	–0.3	2.0	23.7
CAC	4548.0	4707.1	5862.8	2696.9	931.6	–0.4	1.9	30.2
DJIA	11,522.6	12,251.0	14,164.5	7062.9	1951.8	–0.7	2.2	47.2
FTSE	5521.4	5772.0	6730.7	3781.0	847.3	–0.6	2.0	41.1
HSI	21,660.5	22,710.0	31,638.2	11,015.8	5189.7	–0.4	2.0	24.8
NASDAQ	2229.8	2349.5	2859.1	1316.1	424.4	–0.7	2.2	46.3
NIKKEI	12,809.1	13,324.8	17,459.0	7162.9	2921.0	–0.5	2.1	28.7
NYSE	8227.6	8878.0	10,311.6	4617.0	1689.4	–0.8	2.2	57.1
S&P	1253.5	1333.5	1565.2	735.1	237.2	–0.8	2.2	51.3
SSEC	3538.8	3406.5	6092.1	1706.7	1366.4	0.2	1.5	38.5
Phase III								
BSE	17,942.4	17,839.0	21,005.0	14,784.9	13,48.7	0.2	2.4	9.2
CAC	3804.5	3815.8	1457.1	3331.3	180.5	–0.4	2.5	17.4
DJIA	10,903.8	10,680.8	12,810.5	9135.3	926.4	0.3	2.0	26.3
FTSE	5506.9	5538.1	6091.3	4608.4	368.0	–0.2	2.1	21.8

(continued)

Table 13.2 (continued)

	Mean	Median	Max.	Min.	Std. dev.	Skewness	Kur-tosis	JB (all $p < 0.05$)
HSI	21,941.2	21,850.6	24,964.4	18,985.5	1335.0	0.0	2.0	21.6
NASDAQ	2404.1	2346.8	2873.5	1930.8	256.6	0.3	1.8	36.1
NIKKEI	10,018.8	10,013.6	11,339.3	8605.2	545.9	0.2	2.3	12.1
NYSE	7443.2	7310.3	8671.4	6352.1	599.0	0.4	1.9	33.3
S&P	1168.2	1142.7	1363.6	979.7	101.4	0.3	1.9	34.5
SSEC	2884.7	2894.5	3471.4	2364.0	219.7	0.1	2.5	6.0

Table 13.3 Correlation matrices

	BSE	CAC	DJIA	FTSE	HSI	NASDAQ	NIKKEI	NYSE	S_P01
Phase I									
BSE	1.00								
CAC	0.98	1.00							
DJIA	0.94	0.94	1.00						
FTSE	0.96	0.98	0.91	1.00					
HSI	0.92	0.92	0.96	0.88	1.00				
NASDAQ	0.74	0.79	0.82	0.77	0.73	1.00			
NIKKEI	0.86	0.87	0.75	0.88	0.68	0.71	1.00		
NYSE	0.97	0.98	0.98	0.96	0.96	0.81	0.82	1.00	
S&P	0.92	0.94	0.99	0.91	0.95	0.89	0.77	0.98	1.00
SSEC	0.87	0.86	0.92	0.82	0.95	0.62	0.63	0.91	0.88
Phase II									
BSE	1.00								
CAC	0.94	1.00							
DJIA	0.94	0.99	1.00						
FTSE	0.95	0.98	0.98	1.00					
HSI	0.97	0.96	0.96	0.97	1.00				
NASDAQ	0.94	0.97	0.98	0.97	0.96	1.00			
NIKKEI	0.91	0.98	0.98	0.97	0.95	0.98	1.00		
NYSE	0.95	0.98	0.99	0.98	0.97	0.99	0.98	1.00	
S&P	0.94	0.98	1.00	0.98	0.97	0.99	0.98	1.00	1.00
SSEC	0.87	0.90	0.86	0.89	0.87	0.83	0.86	0.85	0.86
Phase III									
BSE	1.00								
CAC	0.42	1.00							
DJIA	0.67	0.73	1.00						
FTSE	0.75	0.81	0.94	1.00					
HSI	0.73	0.73	0.76	0.81	1.00				
NASDAQ	0.70	0.72	0.98	0.95	0.76	1.00			
NIKKEI	–0.29	0.38	–0.04	0.07	–0.04	0.03	1.00		
NYSE	0.62	0.83	0.98	0.94	0.82	0.97	0.07	1.00	
S&P	0.64	0.77	0.99	0.94	0.77	0.99	0.04	0.99	1.00
SSEC	–0.21	0.42	–0.03	0.05	0.27	–0.06	0.43	0.11	0.01

Table 13.4 ADF test results

	Phase I		Phase II		Phase III	
	ADF statistic	ADF statistic	ADF statistic	ADF statistic	ADF statistic	ADF statistic
	Levels	1st diff.	Levels	1st diff.	Levels	1st diff.
BSE	–1.40	–8.09	0.00	–10.17	–2.44	–10.30
CAC	–0.99	–9.46	0.29	–10.23	–3.02	–10.84
DJIA	–0.78	–9.01	0.94	–10.00	–1.20	–10.03
FTSE	–1.60	–8.09	–0.11	–9.65	–2.25	–9.52
HSI	–0.41	–8.67	0.09	–9.50	–2.17	–9.83
NASDAQ	–1.16	–8.82	0.42	–9.90	–1.25	–9.56
NIKKEI	–2.60	–8.62	–0.03	–9.56	–2.73	–11.23
NYSE	–0.79	–8.89	0.88	–9.95	–1.42	–10.16
S&P	–0.67	–9.09	0.92	–10.11	–1.27	–9.88
SSEC	0.53	–7.35	–0.49	–8.28	–2.85	–9.94

Critical values: =–2.57 for $p<0.10$, –2.87 for $p<0.05$, –3.45 for $p<0.01$

Table 13.5 PP statistics for stationarity

	Phase I		Phase II		Phase III	
	PP statistic	PP statistic	PP statistic	PP statistic	PP statistic	PP statistic
	Levels	1st diff.	Levels	1st diff.	Levels	1st diff.
BSE	–1.48	–17.56	–0.11	–18.29	–2.02	–21.06
CAC	–1.07	–21.82	0.33	–22.54	–3.23	–22.25
DJIA	–0.74	–19.98	0.81	–23.95	–1.21	–22.74
FTSE	–1.63	–21.98	–0.15	–21.70	–2.42	–22.28
HIS	–0.40	–19.20	–0.09	–21.37	–2.18	–22.48
NASDAQ	–1.29	–18.87	0.30	–23.32	–1.22	–21.85
NIKKEI	–2.31	–20.24	–0.14	–21.33	–2.86	–22.01
NYSE	–0.81	–19.56	0.76	–23.00	–1.48	–22.79
S&P	–0.76	–20.26	0.77	–24.05	–1.34	–22.82
SSEC	0.79	–18.36	–0.39	–20.18	–2.82	–21.53

Critical values: =–2.57 for $p<0.10$, –2.87 for $p<0.05$, –3.45 for $p<0.01$

are stationary at level 1 in both the phases, statistically determined by both the unit root tests. Hence, all the indices are integrated of order 1. Now we proceed further to co-integration test. Johansen test for co-integration was used to find the co-movement between various indices during the four phases of data considered. Table 13.6 shows the results of Johansen test which can be interpreted as follows:

Table 13.6 Johansen co-integration test results

Unrestricted co-integration rank tests									
	Phase I			Phase II			Phase III		
Hypoth. CEs	λ	Trace stat.	Max λ stat.	λ	Trace stat.	Max λ stat.	λ	Trace stat.	Max λ stat.
None	0.14	272.00**	60.07	0.16	261.22**	69.70**	0.12	277.08**	64.32*
≤1	0.13	211.93**	55.73	0.13	191.52	57.21*	0.11	212.76**	56.712
≤2	0.11	156.21*	46.48	0.10	134.31	40.63	0.08	156.04*	39.04
≤3	0.07	109.73		0.09	93.68	38.06	0.07	117.01	
≤4	0.06	79.16					0.06	83.76	

$*p < 0.05$, $**p < 0.01$

λ = eigen value

As explained in methodology, Johansen co-integration test uses two different approaches in conducting and testing co-integration. By observing the trace statistic value from Table 13.6, in Phase I, the statistic value is greater than the critical value at both 5 % and 1 % confidence level under number of co-integrating equations equal to at most one, thus rejecting null hypothesis and accepting that there exists more than one co-integrating vector. Looking at the values under at most two co-integrating equations, the statistic value is greater than the critical value at 5 % confidence level and less than the critical value at 1 % confidence level, the hypothesis is rejected at 5 % level and accepted at 1 % level. This indicates that there exist three co-integrating equations among all the indices in Phase I at 5 % level and two co-integrating equations at 1 % level. In the same table (Table 13.5), observing the values of Max. Eigen Value statistic, the statistic value is less than the critical value at both 5 % and 1 % confidence levels under number of co-integrating equations equal to none, thus the null hypothesis is accepted. Hence, Max-Eigenvalue test indicates no co-integration at both 5 % and 1 % levels. Trace statistics value observed from Table 13.6 in Phase II shows the statistics value is greater than the critical value at both 5 % and 1 % confidence level, under number of co-integrating equations equal to none, hence rejecting the null hypothesis and accepting that there exists one co-integrating equation at both 5 % and 1 % level. The null hypothesis is accepted for number of co-integrating equations equal to at most one, as the trace statistics value is less than the critical value at both 5 % and 1 % confidence level. Now, considering the Max-Eigenvalue statistics, it is found that the statistics value is greater than the critical value at both 5 % and 1 % confidence level under number of co-integrating equations equal to none; the hypothesis is rejected and indicates the presence of co-integrating vector. Looking at the values under at most one co-integrating equation, the statistic values are less as compared to critical value at 1 % level but greater compared to the value at 5 % confidence level; we reject the null hypothesis at 5 % level and accept at 1 % confidence level. This indicates the presence of two co-integrating equations at 5 % confidence level and one co-integrating equation at 1 % level. By observing the trace statistics value from Table 13.6 in Phase III, it is found that the statistic value is greater than the critical value at both 5 % and 1 % confidence level under number of co-integrating equations equal to at most one, rejecting the null hypothesis and accepting that there exists more than one co-integrating vector. By looking at the values under at most two co-integrating equations, the statistics value is greater than the critical value at 5 % level and less at 1 % level; the hypothesis is rejected at 5 % level and accepted at 1 % level. This indicates the presence of three co-integrating equations at 5 % level and two co-integrating equations at 1 % level. Similarly, Max-Eigenvalue statistics for Phase III points toward existence of one co-integrating equation at 5 % confidence level and no co-integration at 1 % level.

Conclusion

The study compares co-integration among major indices considering three different phases. First, the stock prices taken for the four phases are not normally distributed. Second, we could conclude that the markets are interdependent on each other to maximum extent with slight variations depending on the phase and the markets chosen. Next at first difference level, the data for the selected stock markets are stationary, thus concluding that they all are integrated of order one. Finally, the stock markets have been found to be more co-integrated during the crisis period (Phase II) as compared to the pre-crisis period (Phase I) and recovery period (Phase III); this indicates that the stock markets behave independently during the rise in economies and in contrast they depend on each other or have a mutual impact on each other when any global event occurs. Particularly, the Chinese market among all the markets is least correlated with the other markets during Bear phase, indicating that the impact of the global economic crisis would be less on the China market. This chapter would be of help in providing an insight to the investors in deciding when and where to invest. Further, the study can be extended to include sector-specific impact on the different stock markets.

References

Awokuse, T. O., Chopra, A., & Bessler, D. A. (2009). Structural change and international stock market interdependence: Evidence from Asian emerging markets. *Economic Modeling, 26*(2009), 549–559.

Bardhan, A., Edelstein, R., & Tsang, D. (2008). Global financial integration and real estate security returns. *Real Estate Economics, 36*(2), 285–311.

Bertrand, B. M., & Michel, T. L. (2005). The impact of the 9/11 events on the American and French stock markets. *Review of International Economics, 13*(3), 597–611.

Egert, B., & Kocenda, E. (2007). Interdependence between Eastern and Western European stock markets: Evidence from intraday data. *Economic Systems, 31*(2), 184–203.

Hayo, B., & Kutan, A. M. (2005). The impact of news, oil prices, and global market developments on Russian financial markets. *Economics of Transition, 3*(2), 373–393.

Hon, M. T., Strauss, J., & Yong, S. K. (2004). Contagion in financial markets after September 11: Myth or reality? *The Journal of Financial Research, 27*(1), 95–114.

Kaltenhaeuser, B. (2003, November). *Country and sector specific spillover effects in the EURO area, the United States and Japan* (European Central Bank working paper series paper No. 286). Frankfurt am Main: European Central Bank.

Lim, K. P., Brooks, R. D., & Kim, J. H. (2008). Financial crisis and stock market efficiency: Empirical evidence from Asian countries. *International Review of Financial Analysis, 17*(3), 571–591.

Marashdeh, H. (2005). Stock market integration in the MENA region: An application of the ARDL bounds testing approach. *Working Paper Series, 5*(27), 1–9.

Mukherjee, K., & Mishra, R. K. (2007). International stock market integration and its economic determinants: A study of Indian and world equity markets. *Vikalpa, 32*(4), 4–29.

Mukherjee, K., & Mishra, R. K. (2008). Stock market integration and volatility spillover: India and its major Asian counterparts. *Research in International Business and Finance, 24*(2), 235–251.

Ng, A. (2002). Volatility spillover effects from Japan and the US to the Pacific-Basin. *Journal of International Money and Finance, 19*(2), 207–233.

Raj, J., & Dhal, S. (2008). Integration of India's stock market with global and major regional markets. *BIS Papers No, 42*(8), 181–201.

Reid, C., & Plummer, M. G. (2003). Stock market integration in ASEAN after the financial crisis. *Working Paper Series, 2003*(06), 1–20.

Rim, H., & Setaputra, R. (2010). Study on relationships between financial markets in the US and ASEAN countries. *International Business & Economics Research Journal, 9*(8), 1–6.

Shiok, Y. L., Sheue, L. O., & Chong, M. H. (2012). Co-movement between Malaysian stock index and bond index: Empirical evidence from rank tests for co-integration. *Journal of Applied Finance, 18*(1), 5–20.

Thomas, L. S., & Brian, M. L. (2007). Capital market integration in the Middle East and North Africa. *Emerging Markets Finance and Trade, 43*(3), 34.

Veraros, N., Kasimati, E., & Dawson, P. (2004). The 2004 Olympic Games announcement and its effect on the Athens and Milan stock exchanges. *Applied Economics Letters, 11*(12), 749–753.

Yang, J., Kolari, J. W., & Min, I. (2003). Stock market integration and financial crises: The case of Asia. *Applied Financial Economics, 13*(7), 477–486.

14

Vicious Cross-licensing Strategy for Technology Spread: Case Study of Samsung Electronics

Baba Gnanakumar

Introduction

Software companies in India are losing two-thirds of their revenue in piracy in a year. It also caused \$866 million loss to the Indian government in the year 2011 (PTI, 2011). According to NASSCOM, the compound annual growth rate of IT spending in India was 15 % until 2014 (Sharma, 2011). If PC software piracy is curtailed by 5 %, the ITES revenues will increase to \$790 million, and 26,108 new high-skilled jobs will be created in India (PTI, 2011). If software piracy is reduced by 10 %, the economic benefits for a firm will increase by 31 % in two years. The traditional model of licensing the software such as shrink-wrap, browse-wrap, and click-wrap system has no longer been giving fruitful results in curbing the software piracy. To mitigate the software piracy losses and to get rid of

B. Gnanakumar (✉)
Sri Krishna Arts and Science College, Coimbatore, India
e-mail: gnanakumar12000@yahoo.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_14

litigation expenses on intellectual property rights, technology giants such as Microsoft, IBM, Apple, Samsung, Nokia, and Seagate are entering into cross-licensing agreement (CLA) with regional players and competitors. These cross-licensing contracts not only provide hindrance to piracy but also enhance the technology spread. In this context, the present study intends to identify a competent business model created by the CLA.

Review of Literature

Software piracy is significantly correlated to gross national product per capita, income inequality, and individualism (Husted, 2000). The residual increase in software patent propensity is deteriorating, and it is to be controlled through strategic patenting (Bessen & Hunt, 2007). Technological collaborations are essential for the software servicing companies for their global marketing (Grimaldi & Torrisi, 2001). When technologies are complex, it is essential to share ownership of a product's technology and innovators are forced to have CLA (Bessen, 2004). However, robust cross-industries differences are the main constraints in creating CLAs with respect to ex-post technology transfers and intellectual property rights (Anand & Khanna, 2003). The reciprocal agreement between the technological partners strengthens competition within the partners in the cluster (Lavie, 2007). Cross-licensing in ITES permits offshore entry for the firms even without any previous experience (Cockburn & Macgarvie, 2011). Past literature asserts the merits of the cross-licensing system. The present study aims to identify the cross-licensing models that mitigate technology piracy and increase the earning capacity through market capitalization effect.

Aim and Methodology

The objective of the study is to identify an "Assertive Business Model" that restrains technology piracy in the ITES industries. The secondary aim is to maximize corporate revenues through collaborative ventures in the form of cross-licensing strategy.

Five cross-licensing contracts of AMD, Microsoft, Seagate, Samsung Electronics, IBM, and Yahoo entered during 2010–12 were studied to portray the competent business model.

Cross-Licensing Strategy

Cross-licensing is an agreement between two firms that permits each the right to use the other's patents. It may or may not include annual payment or having royalties, or running royalties in one direction or both. It incorporates the usage of patents in a geographical area, carves out the patent usage in certain products, and fixes a time limit for the contract (Jaffe, Lerner & Stern, 2001). It may also take the form of exchanging the shares in the licensee company for providing the contract license of the intellectual property rights. These agreements are suitable if the parties to the contract follow defined set of interoperability standards for their technology. It originates from a joint venture business model. CLA is suitable if both organizations wish to use the common technology platform for research and development purpose (Morasch, 1995).

Justification of CLA

The traditional purpose of entering the CLA is to mitigate the litigation expenses with regard to technology piracy. These agreements, in the long term, enable the firm to earn profits from market spread created by the high-end business partners. This is substantiated with the case of CLA between Advanced Micro Devices Inc. (AMD) and Intel.

AMD entered a CLA with Intel in November 2009. The terms of the agreement are as follows:

Both firms agreed to a 5-year patent CLA that gives AMD rights to work in multiple foundries.

- Both firms waived all claims on the breach of the previous agreement.
- Intel gave $1.25 billion to AMD.

- AMD withdrew all pending litigation in the USA, two agreements in Japan, and all the regulatory complaints worldwide.
- There are no future payments, or delivery is required for using the fully paid licenses.

After the deal, all the outstanding legal disputes between both companies with regard to antitrust litigation and patent came to an end. AMD's legal expenses, administrative expenses, and amortization expenses decreased by 67 %, 24 %, and 49 %, respectively, in 2010. In the same manner, the legal disputes between Intel versus Nvidia and HP versus Microsoft have been solved by signing a CLA. Microsoft estimated that the opportunity cost lost in every dollar due to software piracy equals to $5.50 in 2008 (Darren Bibby, 2008).

Microsoft entered into CLA with more than 600 regional and international firms to decrease software piracy. More than 250 legal suits are pending in various courts with regard to patent right violation. However, Microsoft was able to resolve only 20 % of disputes so far.

Based on the above case, we concluded that CLAs are motivated in the arbitrage process about the patent problems. Firms are using CLA as a defensive tool in decreasing legal expenses. Firms create virtuous cross-licensing models to shrink the litigation case disputes. Firms that aim to increase the market spread and wish to survive cut-throat competition are following the vicious model of CLA.

Virtuous Cross-Licensing Model

Microsoft created virtuous cross-licensing patent model that enables to protect their patents from third parties. Under the virtuous model of CLA, the contracting parties identify the estimated cost of litigation due to technology infringement, opportunity cost lost due to legal suits, technology piracy cost, and marketing cost before entering into the agreement. The purpose is to get rid of court suits between the parties to contract, competitors' legal suits, and aims to create new marketing opportunities. Figure 14.1 represents the virtuous CLA model created by Microsoft.

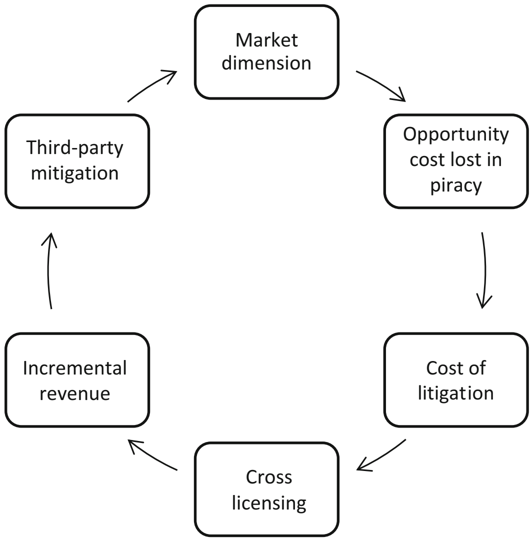


Fig. 14.1 Virtuous cross listing model

Smartphone market witnessed an exponential growth in 2009. The smartphone market grew by 64 % worldwide during 2009. Android device shipment in 2009 increased by 886 % (Constantinescu, 2010). According to Gartner report, smartphone sales grew at the rate of 74 % in 2011 compared to the previous year (Gartner Research, 2011). Smartphone manufacturers are extensively using the Microsoft software. To make use of patent rights, Microsoft has entered patent right royalty agreements with Android manufacturers, namely HTC, Acer, View Sonic, Velocity Micro, and Winston. Microsoft filed suit against Android for violating patents that are offered free to smartphone and tablet manufacturers by Google. Samsung had a majority of market share in Android devices in 2010 and its annual growth rate was 355 % in 2010–11 in smartphone segment (Canalys, 2011). Android smartphone had 43 % market share in the USA (Nielsen, 2011). Samsung's Galaxy Tab tablet was also powered by Android. Apple filed a patent infringement petition against Samsung for using its technology in Galaxy tablet. Microsoft also sued Samsung for paying the royalty for using its software in smartphones.

To resolve the legal problem, Samsung has signed a cross-licensing deal with Microsoft in September 2011 (Microsoft, 2011). The terms of the contract are as follows:

- Microsoft will receive royalties from Samsung for every Android Smartphone produced by Samsung.
- Samsung will facilitate the marketing of the Windows Phone system and develop the Microsoft platform.
- Samsung and Microsoft will stop the legal battles on patent rights linked to Android.

This kind of CLA settled patent lawsuits between Microsoft and Samsung, rather than engaging in a battle in court. This CLA protects both companies from third-party piracy attacks. The reciprocal deal allows Samsung to manufacture innovative products using Microsoft's patent. Windows phone 'Mango' came to market because of the collaborative agreement. However, Google assessed the agreement as a measure to extort profit from others' success.

The virtuous cross-licensing model of Microsoft and Samsung identifies the potential opportunity cost lost due to legal disputes. It also set up a viable method to market the software technology of Microsoft and hardware technology of Samsung.

Vicious CL Model

Samsung Electronics created a vicious cross-licensing model that increased its revenue and market share for their patented technologies. Under this model, the parties to the contract estimate the future market share, create joint development agreements to measure the competitive advantage of both parties, and measure the opportunity cost to be gained before entering into CLA. Figure 14.2 represents the vicious CLA model.

The effect of the agreement results in technology acquisition/brand acquisition and increases the market share for both parties. These agreements reduce the technology competition. It is signed before acquiring the competitors' patent rights over the software/hardware. The legal

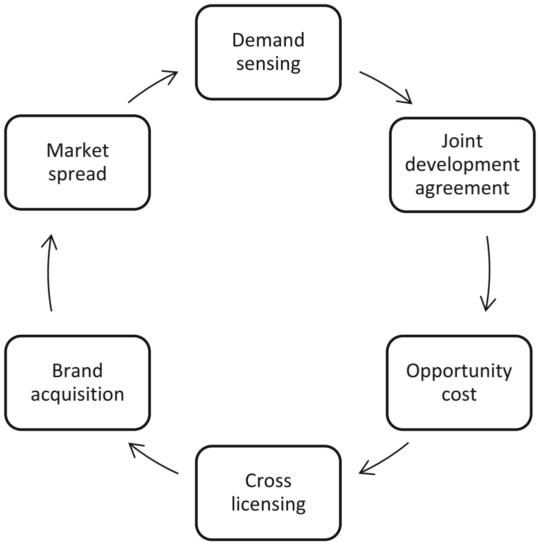


Fig. 14.2 Vicious CLA model

battle over the patent has been avoided. Samsung Electronics CLAs with Seagate and IBM during the period 2010–11 enabled to increase its net revenue by 18 % and mitigated legal suits in court of law.

A licensing agreement entered by Samsung with Micron worth $280 million in October 2010 placed Samsung as the second most inventive company in the world. By that time, the International Data Corporation's hard disk drive market report in the year 2010 quoted that the HDD gross revenue would increase from $33.4 billion in 2010 to $48.2 billion in 2011 (Harris, 2011). Samsung decided to reap the revenues as it is the market leader in HDD. The problem with regard to HDD industries is amortization cost of technology.

Hence, economies of large scale production are essential in HDD industries for cost reduction. In case of SSD industries, Hitachi's multi-year development agreement with Intel achieved the benefits of large scale operations.

After considering the Hitachi and Intel agreement, Seagate Technology and Samsung Electronics entered into a joint development agreement in August 2010. Samsung is the market leader in digital electronics, whereas Seagate is the market leader in hard disk drives.

Through the joint development agreement, both companies had identified their respective strength in the manufacturing sector. Both companies decided to make use of their technology assets to create more innovative products in the fields of solid state storage, mobile computing, and cloud computing. This resulted in signing a CLA in April, 2011 (Seagate, 2011). The objective of the agreement is to strengthen their strategic relationship by establishing joint ownership and investing in new upcoming technologies. The principal terms quoted in the accord are as follows.

- Samsung agreed to supply NAND drivers and semiconductor products to Seagate.
- Seagate agreed to supply hard drives for Samsung computers.
- Both companies agreed to cooperate in developing enterprise storage solutions.
- Purchase consideration paid by Seagate to Samsung was fixed as $1.38 billion. It was in the form of cash (50 %) and stock (50 %).
- Samsung will acquire 10 % stake in Seagate capital and nominate one executive to the board of directors of Seagate.

Upon closing of the deal, Samsung had obtained Seagate's ordinary shares valued at $687.5 million, which was equal to 9.6% stake in Seagate. The price of shares was fixed based on 30 days weighted average share price prior to signing the agreement.

Effect of the Agreement

The strategic alliance enabled Seagate to strengthen its association with SAE Magnetics and TDK Corporation. Samsung and Seagate achieved the benefit of large scale economies within the first year of agreement and introduced innovative storage products to their customers. Seagate's customer base has been spread out to China, Brazil, Germany, Russia, and Southeast Asian countries. Seagate also benefits from the utilization of Samsung assets such as M8 and 2.5 inch HDDs. By utilizing the technical man power resources of Samsung's Korea facility, Seagate developed form-factor product that is used in mobile computing market. Seagate retained the usage of Samsung HDD for 12 months and established a collaborative R&D unit. Based on the successful completion of Samsung and Seagate agreement, Seagate's primary competitor, Western Digital acquired Hitachi's business. Apple also plans to acquire Anobit, an SSD controller technology company.

Market Implication

Due to CLA, the hard disk drive market leaders were reduced to three suppliers, that is, Seagate, Western Digital, and Toshiba. Within four months, the total shipment share (sales) for Seagate and Samsung was around 90 %. This move helped to even out the competition among the remaining HDD suppliers. After the CLA, Toshiba's market share reduced to 10 %. However, Toshiba changed its marketing strategy and decided to concentrate on the notebook computer category. Toshiba's notebook computer sales rose by 10 % within six months. Toshiba maintains its lead in "fat tablet" business applications over Samsung.

Competitive Environment

If the CLA is entered between competitors, it leads to concentration of the market rather than perfect competition. Hence, statutory provisions of different countries are to be considered in finalizing the deals. "Herfindahl-Hirschman Index" (HHI) is usually calculated to find out the concentration of markets due to joint cooperative agreements. Factors such as product consistency, market intelligibility, product uniqueness, countervailing buying power, purchasing methodologies, non-compete bonds, market entry constraints, impediments in intellectual property, territorial limits, technical know-how, and scale competences are considered in calculating the HHI. HHI is calculated based on the sum of the squares of market share of the competing firm. The score ranges from zero to 10,000. If the score is more than 1800, the market is said to be concentrated or less competitive. Competition is moderate if the score is between 1000 and 1800. A score less than 1000 implies that there is a perfect competition even after the acquisition. US and Chinese courts follow the HHI system to identify market concentration and thereby reduce the monopoly.

The CLA among Samsung, Seagate, and Micron led to creating an HHI score of 4004 for Samsung in HDD market ($48^2 + 40^2 + 12^2 = 4004$). This reflects that the CLA entered by Samsung decreased the competition in HDD market. Hence, the Chinese government endorsed the Samsung and Seagate deal by imposing following restrictions:

- Samsung's HDD must be sold only after one year from the date of CLA.
- Production capacity of Samsung hard drives must be increased after six months from the date of CLA.
- A separate production unit must be established by Seagate for Samsung-branded hard drive.
- Seagate should disclose information on prices, volumes, or business strategy to the Chinese government.

Both the firms are benefited because of decrease in competition. However, monopoly has been prevented in HDD markets by the legal rules prevailing in the respective countries.

Impact on Profit

The cost of acquisition of both companies has been offset by the incremental revenue from market expansion. The litigation cost has been decreased. Technology piracy has been mitigated by the market spread. Immediately after the CLA, Samsung's sales growth rate was 6.663 % (quarter ending June, 2011) as compared to the previous quarter "−11.67%" (March 2011) (Source: 2012 FactSet Research Systems Inc.).

Subsequent Agreements

On February 2011, Samsung entered a patent CLA with IBM. This CLA enabled the two companies to use both companies' patented innovative technologies according to the business demands and maintain competition with others. However, these agreements are not created as an effect of minimizing legal expenses, but to sustain as a market leader and to reduce technology piracy.

Apple Versus Samsung Case

Apple proffered a CLA to Samsung in 2010 for using 3G/UMTS under FRAND (fair, reasonable, and non-discriminatory) terms involving 0.33US$ per unit sold as royalty (Seltzer, 2012), and Samsung turned down the offer (Mello, 2012).

On April 15, 2011, Apple filed an infringement petition against Samsung in US District Court of California. The court granted $1,051,855,000 to Apple from Samsung. In the next hearing, Apple contended in Court for a ban on Samsung's 4G Smartphone and Galaxy 10.1. The court declined the petition ruling in favor of Samsung (Kelion, 2012).

In South Korea, the Court decision was of $20 million in damages for each violated patent by Apple, and $25 million by Samsung. The Court found that Apple infringed two of Samsung's technology patents and ordered Apple to stop sales of the infringed product in South Korea. Samsung infringed Apple's "Bounceback" patent but not the icon (Ramstad & Lee, 2012).

UK Court denied Apple's infringement petition against Samsung stating that there was no case of infringement by Samsung, and ordered Apple to pay the legal charges (Whittaker, 2012).

In the Netherlands, the Dutch Court coincides with the UK Court ruling that Samsung has not infringed design patents of Apple in Samsung Galaxy Tab. The Court specified that the amount payable was to be calculated on the sales of iPhone and iPad in the Netherlands (BBC News, 2012).

Even though Apple succeeded in US court awarding USD 1.05 million, Samsung has successfully picked up the market from the rival. When Apple focused on sales to their loyal customers, Samsung widened their range to match most customer demands by introducing more models. This has resulted in change of market holdings.

Implications

Reciprocal agreements with competitors, technology providers, and diversified business partners pave the way for creating lucrative profits in the long run. The virtuous cycle model in cross-licensing can be transformed to a vicious cycle model to ensure technological spread. The royalty cost in joint agreements is offset by the market spread. Samsung's cross-licensing deal with Microsoft was a defensive tactic to get rid of the litigation attacks, whereas Samsung's deal with Seagate was an assertive tactic which led to establishing the market leader in a particular product line. As IT industries are entering into a hyper-competitive world, it is essential to have strategic alliances with regional partners. The various stages in vicious model of CLA have been optimally used by Samsung. They are listed as follows.

Stage I Demand sensing: Samsung aimed to utilize the large scale economies of production, introduce a new product, avoid future litigation expenses, and extend the market spread without affecting its brand name. Hence, it considered the IDC report to sense the future demand in HDD sector. The technology competitors were listed by Samsung.

Stage II Joint development agreement: Samsung did not want to have direct CLA without considering the SWOT analysis of Seagate. Hence, it signed a joint development agreement. The feasibility of having CLA was identified by Samsung by considering HHI factors.

Stage III CLA pact: The gaining and sacrificing arguments about CLA were put forward by the advisors of Samsung and Seagate. Allen & Company LLC and Morgan Stanley & Co served as the financial advisors to Samsung and Seagate, respectively. Janofsky & Walker LLP and Wilson Sonsini Goodrich served as legal advisors to Samsung and Seagate, respectively. The agreement was specific in nature about the product development.

Stage IV Brand acquisition: The CLA resulted not only in brand acquisition, but also acquisition of ownership. Samsung acquired around 10 % stake in Seagate and Samsung nominated one director in the board of directors' team of Seagate. This enabled to clinch the administrative strategies taken by Seagate.

Stage V Market consolidation: CLA agreement favors both companies to enlarge its market boundary. Seagate entered into South Asian countries. Samsung's global brand positioning increased in HDD market, and the competition decreased. However, the market concentration report has to be considered for ethical values that lead to perfect competition.

CLA with competitors strongly supports D'Aveni's concept that firms will go through escalating stages of competition in case of hypercompetition (D'Aveni, 1994). Strategic alliances not only save the litigation cost/piracy cost but also reap revenues. After the Microsoft—Yahoo cross-licensing pact of 2009, for using Microsoft platform in Yahoo search engines, Yahoo's income increased by $500 million annually and Microsoft is also able to protect its software patent.

Conclusion

Cross-licensing models share the major physical assets of both parties and aim to protect their intellectual property rights. Technology piracy can be mitigated through these licensing systems. The success of the cross-licensing model depends upon identifying the business partners and to what extent the resources resulting from joint cooperation are compatible. Multiple business models are essential for a single firm while dealing a pact with others. A competitive CLA with regional technological partners is not a risky one, but it is considered to be a new business strategy to get rid of tangible losses.

Acknowledgment The author acknowledges **Seongwoo Kim, Director, Licensing Team, IP Center, Samsung Electronics, Korea** for providing the inputs for writing the case.

References

Anand, B. N., & Khanna, T. (2003). The structure of licensing contracts. *The Journal of Industrial Economics, 48*(1), 103–135.

BBC News. (2012). Apple ordered to pay damages to Samsung by Dutch court. *BBC News Business.* Retrieved from http://www.bbc.co.uk/news/business-18529756

Bessen, J. (2004). Patent thickets: Strategic patenting of complex technologies (Working paper, http://researchoninnovation.org/thicket.pdf).
Bessen, J., & Hunt, R. M. (2007). An empirical look at software patents. *Journal of Economics and Management Strategy, 16*(1), 157–189.
Bibby, D., Gantz, J., & White, A. (2008). *The impact of software piracy and license misuse on the channel*. IDC Partner Piracy Impact Study.
Canalys (2011). Android takes almost 50% share of worldwide smart phone market. Canalys. https://www.canalys.com/newsroom/android-takes-almost-50-share-worldwide-smart-phone-market.
Canalys. (2013). Android powered a third of all mobile phones shipped in Q4 2012. Canalys. Retrieved dated February 7. http://www.canalys.com/newsroom/android-powered-third-all-mobile-phones-shipped-q4-2012
Cockburn, I. M., & Macgarvie, M. J. (2011). Entry and patenting in the software industry. *Management Science, 57*(5), 915–933.
Constantinescu, S. (2010). *Smart phones shipments grew 64% world wide, Android grew 886% too*. Retrieved February 28, 2011, from http://www.intomobile.com/2010/08/02/smartphones-shipments-grew-64-world-wide-android-grew-886-too/
D'Aveni, R. A. (1994). *Hypercompetition: Managing the dynamics of strategic Maneuvering*. New York: Free Press.
Gartner Research. (2011, August 11). *Sales of mobile devices in second quarter of 2011 grew 16.5 percent year-on-year; Smartphone sales grew 74 percent*. Stamford: Gartner Inc. Available from http://www.gartner.com/newsroom/id/1764714
Grimaldi, R., & Torrisi, S. (2001). Codified-tacit and general-specific knowledge in the division of labour among firms: A study of the software industry. *Research Policy, 30*(9), 1425–1442.
Harris, C. (2011, June 10). Future of HDD market lies in hybrid drives. *Information Week*.
Husted, B. W. (2000). The impact of national culture on software piracy. *Journal of Business Ethics, 26*(3), 197–211.
Jaffe, A. B., Lerner, J., & Stern, S. (2001). Navigating the patent thicket: Cross licenses, patent pools and standard setting. *Innovation Policy and the Economy, 1*, 119–150.
Kelion, L. (2012). Apple versus Samsung: Jury foreman justifies $1bn verdict. *BBC News Technology*. Retrieved August 31, 2012, from http://www.bbc.co.uk/news/technology-19425052
Lavie, D. (2007). Alliance portfolios and firm performance: A study of value creation and appropriation in the U.S. software industry. *Strategic Management Journal, 28*(12), 1187–1212.

Mello, J. P. (2012). Analyst: Cross-licensing will be the conclusion to Apple v. Samsung trial. *PCWorld*. Retrieved August 22, http://www.pcworld.com/article/261263/analyst_cross_licensing_will_be_the_conclusion_to_apple_v_samsung_trial.html

Microsoft. (2011). Microsoft and Samsung broaden smartphone partnership. Retrieved March 10, 2012, from https://news.microsoft.com/2011/09/28/microsoft-and-samsung-broaden-smartphone-partnership/#sm.001xe8inn131uemwwj21d2c1teym9, dated September 28.

Morasch, K. (1995). Moral hazard and optimal contract form for R&D cooperation. *Journal of Economic Behavior and Organization, 28*(1), 63–78.

Nielsen. (2011). *Android's US market share nearing 50% in latest Neilsen Report*. Nielson Inc.

PTI. (2011, May 31). Software piracy caused tax loss of $866 mn in FY09. *Business Standard*.

Ramstad, E., & Lee, M. S. (2012). South Korea court says Samsung, Apple infringed each other's patents. *The Wall Street Journal*. Retrieved August, 24, http://online.wsj.com/article/SB1000087239639044481270457760824279292 1450.html

Seagate (2011). Seagate and Samsung announce broad strategic alignment. Retrieved March 10, 2012, from http://www.seagate.com http://www.informationweek.com/apple-offered-patent-cross-license-to-sa/240005344

Seltzer, L. (2012). Apple offered patent cross-license to Samsung. *Information Week*. Retrieved August 10. http://www.informationweek.com/apple-offered-patent-cross-license-to-sa/240005344

Sharma, O. (2011, June 23). Software piracy is eating into India's growth. Data Quest.

Whittaker, Z. (2012). Apple ordered to pay Samsung's U.K. legal fees. Available from http://news.cnet.com/8301-13579_3-57548418-37/apple-ordered-to-pay-samsungs-u.k-legal-fees/, Retrieved from News. Cnet: http://www.samsung.com/, http://www.seagate.com/, https://www.microsoft.com/en-in/, http://www.ibm.com/

Part V

Managing People in Emerging-Market Firms

15

Repatriates' Organizational Commitment in the Indian Information Technology (IT) Environment

Krishnaveni Muthiah and B.R. Santosh

Introduction

Expatriation is the process of sending employees to another country, for example, managers who are posted overseas to lead a subsidiary of a multinational enterprise (MNE). Companies spend huge amounts of money on their expatriates. For example, Stelmer (2001) estimated that most companies spend between US $300,000 and US $1,000,000, annually, on each individual on foreign assignment. On completion of the international assignment (or multiple such assignments), the expatriates return home, and then the process of repatriation begins. However, companies often underestimate the extent and importance of the repatriation

K. Muthiah (✉)
PSG College of Technology, Coimbatore, India
e-mail: krishnavenimuthiah@psgim.ac.in

B.R. Santosh
Al Musanna College of Technology, Muscat, Oman
e-mail: santoshbirur@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_15

process, on the basis that the employees are just "coming back home" and thus will have no difficulties in adjusting to their own environment (Stroh et al., 1998; Adler, 1981; Tung, 1998). Such underestimation of the repatriation process is viewed as a contribution factor for the high turnover among repatriates. There is strong evidence that employees who have been sent to work abroad are more likely to seek new job opportunities than those who have remained in the home country (Stroh, 1995).

According to Brookfield Global Relocation Trends Report (2011), of the 118 companies participating in the Trends Report, 28 % of repatriates quit their organization within one year of returning from their assignments, and the 15-year historical average indicates 22 % of repatriates quit their organization within one year of returning from their assignment compared with an average annual employee turnover rate of 8 % in these same 118 companies. Furthermore, the cost of replacing an employee who leaves the company is on the order of 29 % (for non-management staff) and 46 % (for management staff) of the person's annual salary (Bernthal & Wellins, 2001).

There are different reasons for employees' resignations. Some suggest that the repatriates do not perceive that there remain appealing career opportunities in the companies for which they have been working (e.g., Paik, Segaud & Malinowski, 2002). Others argue that a key reason is the lack of a repatriation program (e.g., Hurn, 1999). Repatriates tend to report lower turnover intentions if, upon return, they gain access to a suitable position within the MNE and experience minimal cross-cultural readjustment difficulties (Leiba O'Sullivan, 2002). In addition, employees who have low commitment to the organization are more likely to resign, whereas repatriates who feel committed to the company are more willing to share the knowledge that they have gained abroad (Oddou, Osland & Blakeney, 2009).

The major factors leading to consideration of turnover are generally viewed as adjustment difficulties, career prospects, external job offers, salary level, organizational status, lack of clarity about the position in the parent company, unsatisfactory repatriation treatment, and decreased organizational commitment (Vdal, Valle, & Aragón, 2007). The objective of this study is to consider repatriates' turnover intention from a psychological perspective. We investigate this by examining the relationship between the organizational commitment and turnover intention of repatriates, in the context of Indian information technology (IT) firms.

Literature Review

The concept of organizational commitment has attracted considerable research attention, in efforts to understand and clarify the intensity and stability of an employee's dedication to the company (Lumley, 2010). In the context of the present study, organizational commitment has been defined as "a psychological state that characterizes an employee's relationship with an organisation and has implications for the decision to continue membership of the organisation" (Allen & Meyer, 1990: 2).

Individuals with higher levels of organizational commitment have a stronger sense of belonging and identification with the organization, which increases their desire to pursue actions consistent with the organization's goals and activities, along with their willingness to remain a part of the organization (Meyer & Allen, 1990). Higher organizational commitment is consistent with a weaker desire to leave the organization, and results in lower intention to resign (Lee & Maurer, 1999). Moreover, organizationally committed individuals are far less likely to engage in absenteeism (Golden & Veiga, 2008). Organizational commitment is a critical factor for keeping high-performing repatriates in the firm after their return from global assignments (Black, Gregersen, & Mendenhall, 1992). In a review of research on organizational commitment, Meyer, Stanley, Herscovitch, and Topolnytsky (2002) suggested that workers with higher levels of organizational commitment may persist in behavior that benefits the company, even when it appears to be contrary to their own self-interest. This implies that, even though a worker understands that his/her knowledge could result in a better job opportunity elsewhere, he/she may remain with an organization because the desire to be identified with, and involved with, that particular organization makes him/her willing to continue to contribute to it. A meta-analysis of antecedents of turnover indicated that organizational commitment is negatively related to turnover, and a better predictor of turnover than other workplace attitudes such as job satisfaction (Griffeth, Hom & Gaertner, 2000).

Research suggests that, during the process of repatriation, multinational firms are likely to benefit from taking actions to enhance the expatriate's commitment to the parent organization, and to develop commitment to the new local work unit, in order to facilitate the retention of these strategic human resources (Gregersen, 1992). The high direct and indirect costs associated with losing a repatriate employee, along with the intangible loss of that person's knowledge and valuable experience, means that this commitment-developing effort is important to undertake (e.g., Brewster, 1997; Gregersen & Black, 1995).

Meyer and Allen (1991) distinguished among three forms of organizational commitment:

- **Affective** commitment refers to an employee's identification, or strong emotional attachment to and involvement in, the organization.
- **Continuance** commitment refers to an employee's awareness of the costs associated with leaving the organization.
- **Normative** commitment refers to a feeling of moral obligation to continue working for a particular organization.

Each of these commitment forms contributes to strengthening the likelihood that the employee will remain in the organization, but their natures differ. Employees with a strong affective commitment bond remain with the organization because they want to do so. Those with strong continuance commitment stay because they feel they have to stay. Normatively committed employees remain because they feel that this is what they ought to do (e.g., Rego & Cunha, 2008; Parish, Cadwallader & Busch, 2008). In the following sections, we describe each of these in more detail, as part of the three-component model of organizational commitment (Meyer & Allen, 1991) that has attracted substantial attention since its development.

Affective Commitment

Affective commitment pertains to the emotional component of an employee's attachment to the organization. Employees with strong affective commitment remain in the organization because this is what they want to do. Affective commitment has been found to be negatively associated with the extent of voluntary absence from work (Meyer et al., 1993) and positively related to work performance that is operationalized using both self-reported and objective measures (Meyer et al., 1993). A worker's desire to exert effort for the benefit of the organization (i.e., affective commitment) may make him/her less sensitive to cues that might possibly limit such efforts. Further, affective commitment has been identified as being positively related to the perception of fairness in organizational justice, the degree of autonomy, and the perception of having a challenging job (Kim & Mauborgne, 1993). Research pertaining to personal characteristics has shown that affective commitment is not significantly associated with gender, marital status, or educational achievements, but that it displays a weak positive relationship with age, organizational tenure, and perceived competence (Mathieu & Zajac, 1990).

Affective commitment results in strong affection toward a job. Affection toward the job occurs when the employee feels a strong emotional attachment to his/her organization, and to the work that it does. The employee is most likely to identify with the organization's goals and values, and genuinely want to be there. People with high affective commitment have been shown to actively undertake extra roles or have strong organizational citizenship behaviors, and to perform activities such as mentoring, problem solving, volunteering for special activities—generally going beyond their job duties (Meyer & Allen, 1997). Affective commitment has been found to be positively related to job challenge, the degree of autonomy, skill diversity, which refers to the degree to which a job requires a variety of challenging skills and abilities that provide an employee the opportunity to undertake a wide range of options in his/her job (Mathieu & Zajac, 1990; Dunham, Grube & Castaneda, 1994), participation, leader consideration, and supervisory support (Decottis & Summers, 1987; Mottaz, 1988).

On the other hand, repatriates' affective commitment is lowered if upon return they find themselves being placed in non-challenging jobs, with a lack of promotion opportunities, a lack of a future plan, role ambiguity, role conflict, a lack of support, and sluggish career advancement. Furthermore, affective commitment has been found to have an inverse relationship to voluntary absence from work and is positively associated to job performance (Meyer et al. 1993).

Continuance Commitment

This type of commitment has to do with the employee's own assessment and awareness of the personal costs that would be associated with leaving the organization. Employees whose commitment is primarily continuance-driven are likely to remain with the organization because they perceive this as a necessity. Continuance commitment is affected by factors such as benefits that the employee may receive that are unique to the organization and tends to be positively associated with employment tenure (e.g., Reichers, 1985). Meyer and Allen (1997) stated that, when employees share continuance commitment with their employer, it can be very difficult for the employees to leave the organization.

Normative Commitment

This attribute pertains to an employee's feeling of obligation to the organization, based on one's personal norms and values. Weiner (1982) discussed normative commitment as being a "generalized value of loyalty and duty", a definition echoed by Meyer and Allen (1991: 418). Employees whose commitment to the organization is primarily of the normative type tend to remain in the organization simply because they believe that they ought to do so; their organizational commitment is effectively based on moral obligation. Wiener (1982) noted that normative commitment can be driven by other commitments such as marriage, family, and religion.

Research Gap and Hypotheses

Over the years, little research has focused on the last part of the international assignment—repatriation—and, in particular, repatriates' organizational commitment. In addition, since most of the studies in this field have been conducted in western empirical settings, the results may not be applicable to the Indian context. Further, to date, there has been very limited study undertaken to explore repatriate commitment in the context of the Indian IT sector, despite the global importance of this industry and the extensive use of expatriates among Indian IT MNEs.

On the basis that the Indian context is quite specific, in terms of its cultural, economic, and social attributes, the present research focuses on repatriated executives working for Indian IT MNEs. These repatriates represent a relatively unexplored group, despite their critical importance to the MNEs. These are high-demand and high-impact employees, and the organizations have strong motivation to retain these executives, especially following international assignments, in order to recoup the companies' investments and to benefit from the knowledge that the executives have gained while working overseas.

Based on the foregoing theory and past research, the following hypotheses were developed:

H1 Repatriates' organizational commitment is negatively related to turnover intention.

H1a Repatriates' affective commitment is negatively related to turnover intention.

H1b Repatriates' continuance commitment is negatively related to turnover intention.

H1c Repatriates' normative commitment is negatively related to turnover intention.

The conceptual model for the study is presented in Fig. 15.1.

Methodology

The research study on repatriates' turnover intentions in IT organization was focused on the software professionals of South India's major IT hub: Bangalore. For the purpose of this study, repatriates do not include inpatriates, short-term assignees, and self-initiated assignees. Software professionals for the study were selected from IT companies selected from the National Association of Software and Services Companies report during FY 2011–2012, which created the sampling frame. Out of the 20 companies identified and contacted, the researchers were able to collect

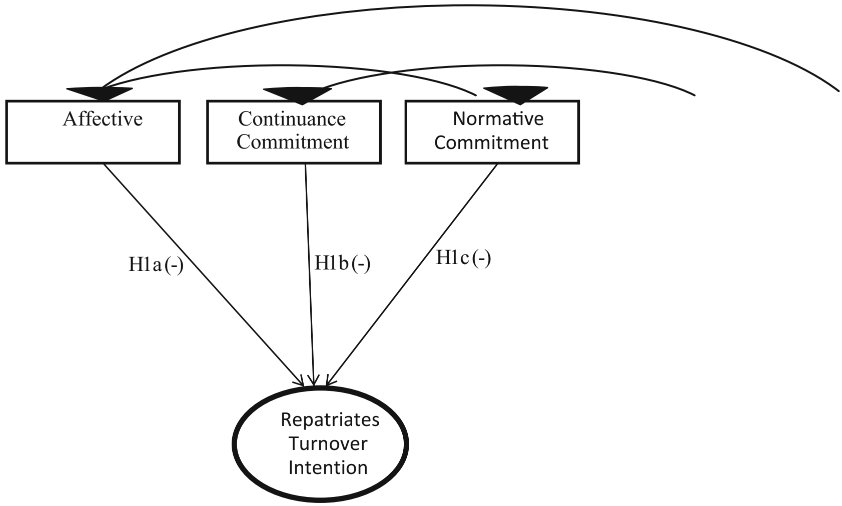


Fig. 15.1 Conceptual model for repatriates' organizational commitment and turnover intention

responses from eight firms. We contacted only those repatriates who had at least one year of international experience in their most current overseas assignment and those employees who have returned to India during the past three years. The data were collected in the first half of 2012.

The repatriates' organizational commitment was measured as affective, continuance, and normative commitment. The survey consisted of 24 questions, which were measured on five-point Likert scales (where 5 = strongly agree, 4 = agree, 3 = neutral, 2 = disagree, 1 = strongly disagree). The instrument was developed with inputs from practitioners and academicians, and a wide range of literature studies (Allen & Meyer, 1990).

The repatriates' organizational commitment construct was initially represented using three sub-constructs and 24 indicators (eight for each aspect of commitment). Refinement of the scales was undertaken using corrected-item total correlation (CITC) scores for each sub-construct. These scales' information is provided in Tables 15.1, 15.2, and 15.3.

In addition to the statistical assessment of the data, reliability and validity were enhanced by undertaking a pilot study using the survey

Table 15.1 Repatriates' affective commitment: Indicator description, CITC, and Cronbach's α values

	Items	CITC I	α if item deleted
1	I would be very happy to spend the rest of my career with this organization	0.602	0.845
2	I enjoy discussing my organization with people outside it	0.838	0.813
3	I really feel as if this organization's problems are my own	0.507	0.855
4	I think that I could easily become as attached to another organization as I am to this one	0.587	0.846
5	I do not feel like "part of the family" at my organization	0.472	0.859
6	I do not feel "emotionally attached" to this organization	0.766	0.825
7	This organization has a great deal of personal meaning for me	0.648	0.839
8	I do not feel a *strong* sense of belonging to my organization	0.434	0.861
α for the factor		**0.861**	

Table 15.2 Repatriates' continuance commitment: Indicator description, CITC, and Cronbach's α values

	Items	CITC I	Alpha if item deleted
1	I am not afraid of what might happen if I quit my job without having another one lined up	0.484	0.778
2	It would be very hard for me to leave my organization right now, even if I wanted to	0.475	0.779
3	Too much in my life would be disrupted if I decided I wanted to leave my organization now	0.464	0.781
4	It would not be too costly for me to leave my organization now	0.589	0.761
5	Right now, staying with my organization is a matter of necessity as much as desire	0.385	0.791
6	I feel that I have too few options to consider leaving this organization	0.493	0.777
7	One of the few serious consequences of leaving this organization would be the scarcity of available alternatives	0.711	0.738
8	One of the major reasons I continue to work for this organization is that leaving would require considerable personal sacrifice—another organization may not match the overall benefits I have here	0.441	0.785
α for the factor		**0.797**	

Table 15.3 Repatriates' normative commitment: Indicator description, CITC, and Cronbach's α values

	Items	CITC I	Alpha if item deleted
1	I think that people these days move from company to company too often	0.318	0.780
2	I do not believe that a person must always be loyal to his or her organization	0.317	0.780
3	Jumping from organization to organization does not seem at all unethical to me	0.314	0.781
4	One of the major reasons I continue to work for this organization is that I believe that loyalty is important and therefore feel a sense of moral obligation to remain	0.642	0.727
5	If I got another offer for a better job elsewhere I would not feel it was right to leave my organization	0.362	0.776
6	I was taught to believe in the value of remaining loyal to one organization	0.727	0.710
7	Things were better in the days when people stayed with one organization for most of their careers	0.739	0.707
8	I do not think that wanting to be a "company man" or "company woman" is sensible anymore	0.429	0.770
α for the factor		**0.781**	

instrument. The pilot study included 40 middle-level employees from two organizations; these responses were excluded from the final sample. Criterion validity is enhanced by the detailed literature review, and content validity through the accessing of expert opinion.

Results and Discussion

The model depicted in Fig. 15.1 was estimated using a latent path model and the AMOS software. The variables included in the model are affective, continuance, and normative commitment, along with turnover intentions. The resulting structural model is portrayed in Fig. 15.2, which indicated the impact of the variables on repatriate turnover intention.

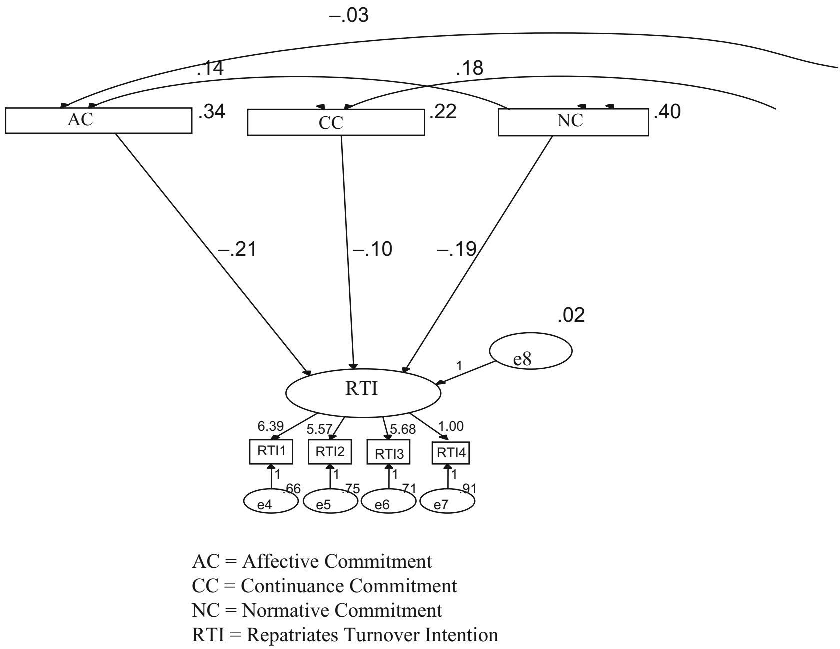


Fig. 15.2 Structural equation model for repatriates' organizational commitment

For the structural equation model, the χ^2 value is 13.861with 11 degrees of freedom. The observed significance level of 0.024 is along expected lines and considered to be satisfactory.

Consistent with the expectations, the results of the modeling indicate that each of the three aspects of organizational commitment is inversely related to post-repatriation intention to leave. Based on our sample, when employees are committed to their organization, they are more reluctant to exit from their current position. The influences of affective, continuance, and normative commitment on turnover intention are all significantly negative, offering support to all three of the hypotheses. Of these, affective commitment and normative commitment each has a dominant negative significant effect on repatriates' turnover intention. The results are summarized in Table 15.4.

Table 15.4 Estimates of factors under study

			Estimate	S.E.	C.R.	P
RTI	←	AC	−0.21	0.016	−0.748	0.049
RTI	←	CC	−0.10	0.017	−1.162	0.025
RTI	←	NC	−0.19	0.020	−0.639	0.023
RTI4	←	RTI	1.000			
RTI3	←	RTI	5.677	2.807	2.023	0.043
RTI2	←	RTI	5.569	2.755	2.021	0.043
RTI1	←	RTI	6.393	3.158	2.025	0.043

Model fit summary

Model	RMR	GFI	AGFI
Default model	0.023	0.987	0.968
Saturated model	0.000	1.000	
Independence model	0.202	0.831	0.774

Further, to assess the model fit, root mean square residual (RMSR), goodness of fit index (GFI), and the adjusted goodness of fit index (AGFI) were calculated. The RMSR value of 0.05 reflects a useful model fit, and the GFI and AGFI are above 0.95, reflecting an acceptable fit to the data. Thus, the model indicates that the psychological variables employed in the study are useful for explaining turnover intention among repatriated employees in Indian IT companies.

Limitations of the Study

To put the findings and conclusions of this study in perspective, it is necessary to outline the limitations to the scope, generalizability, and acceptability of the findings. The first limitation is that the study does not include control variables, such as gender, age, length of the international assignment, return date, and position in the company. Another limitation is that the sample is limited to repatriated employees of IT firms in Bangalore alone, where talent is abundant. Replication of the study in different geographical locations and cultural environments would reveal a more refined picture on repatriates' turnover intentions.

Managerial Implications and Contribution to the Literature

We have shown that a three-component model of organizational commitment is useful for understanding the turnover intentions for our sample of repatriates, providing support to the view of Burton et al. (2005).The result revealed a significant inverse relationship between affective organizational commitment and turnover intention, which was an important and surprising finding in this study, not because of the uniqueness of finding, as this relationship is well-established in the literature, but due to the finding in the context of repatriated software professionals. The result indicated that repatriated employees tend to feel strong identification with the work itself; this may suggest that they feel a stronger attachment to their profession than to the firm in which they are employed. This level of self-identification with work suggests that dissatisfaction with the job may be more likely to spur them to move elsewhere, especially in light of the many opportunities in the Bangalore setting. The results of this study provide preliminary evidence that knowledge workers are committed to their employing organizations, albeit in a more nuanced manner than that is generally acknowledged. The traditional mechanisms of securing commitment from employees using pay and offers of job security are certainly not sufficient for managing contemporary knowledge workers. MNEs need to have mechanisms in place that will value and support the returning employee.

References

Adler, N. J. (1981). Re-entry: Managing cross cultural transitions. *Group and Organizational Studies, 6*(1), 341–356.

Allen, N. J., & Meyer, J. P. (1990). The measurement and antecedents of affective, continuance and normative commitment to the organization. *Journal of Occupational Psychology, 63*(1), 1–18.

Allen, N. J., & Meyer, J. P. (1991). A three-component conceptualization of organizational commitment. *Human Resource Management Review, 1*(1), 61–98.

Bernthal, P. R. & Wellins, R. S. (2001). Retaining talent: A benchmarking study. *HR Benchmark Group, 2*(3). Available at http://www.ddiworld.com/ddi/media/trend-research/retainingtalentabenchmarkingstudy_fullreport_ddi.pdf

Black, J. S., Gregersen, H. B., & Mendenhall, M. E. (1992). Toward a theoretical framework of repatriation adjustment. *Journal of International Business, 24*(1), 737–760.

Brewster, C. (1997). International HRM: Beyond expatriation. *Human Resource Management, 7*(3), 31–43.

Brookfield Global Relocation Trend report. (2011). Available from: http://expatriateconnection.com/wp-content/uploads/2013/09/Brookfield-global-mobility-survey-2011.pdf

Burton, W., Chen, C. Y., Conti, D. J., Schultz, A. B., Pransky, G., & Edington, D. W. (2005). The association of health risks with on-the-job productivity. *Journal of Occupational and Environmental Medicine, 47*(8), 769–777.

DeCottis, T. A., & Summers, T. P. (1987). A path analysis of a model of the antecedents and consequences of organizational commitment. *Human Relations, 40*(1), 445–470.

Dunham, R., Grube, J., & Castaneda, M. (1994). Organisational commitment: The utility of an integrative definition. *Journal of Applied Psychology, 79*(1), 370–380.

Golden, T. D., & Veiga, J. F. (2008). The impact of superior–subordinate relationships on the commitment, job satisfaction, and performance of virtual workers. *The Leadership Quarterly, 19*(1), 77–88.

Gregersen, H. B. (1992). Commitments to a parent company and a local work unit during repatriation. *Personnel Psychology, 45*(1), 29–36.

Gregersen, H. B., & Black, J. S. (1995). Keeping high performers after international assignments: A key to global executive development. *Journal of International Management*, *1,* 3–31.

Griffeth, R. W., Hom, P. W., & Gaertner, S. (2000). A meta-analysis of antecedents and correlates of employee turnover: Update, moderator tests, and research implications for the millennium. *Journal of Management, 26*(1), 463–488.

Hurn, B. J. (1999). Repatriation—the toughest assignment of all. *Industrial and Commercial Training, 31*(6), 224–228.

Kim, W. C. & Mauborgne, R. A. (1993). Procedural justice, attitudes, and subsidiary top management compliance with multinationals' corporate strategic decisions. *The Academy of Management Journal*, *36*(3), 502–526.

Lee, T. W., & Maurer, S. (1999). The effects of family structure on organizational commitment, intention to leave and voluntary turnover. *Journal of Managerial Issues, 11*(4), 493–513.

Leiba O'Sullivan, S. (2002). The protean approach to managing repatriation transitions. *International Journal of Manpower, 23*(1), 597–616.

Lumley, E. (2010). *Exploring the relationship between career anchors, job satisfaction and organisational commitment*. Unpublished master's dissertation, Department of Industrial and Organisational Psychology, University of South Africa, Pretoria.

Mathieu, J. E., & Zajac, D. (1990). A review and meta-analysis of the antecedents, correlates, and consequences of organizational commitment. *Psychological Bulletin, 108*(1), 171–194.

Meyer, J. P., & Allen, N. J. (1997). *Commitment in the workplace: Theory, research and application*. London: Sage.

Meyer, J. P., Allen, N. J., & Smith, C. A. (1993). Commitment to organizations and occupation: Extensions and test of a three-component conceptualization. *Journal of Applied Psychology, 78*, 538–551.

Meyer, J. P., Stanley, D. J., Herscovitch, L., & Topolnytsky, L. (2002). Affective, continuance, and normative commitment to the organization: A metaanalysis of antecedents, correlates, and consequences. *Journal of Vocational Behavior, 61*(1), 20–52.

Mottaz, C. J. (1988). Determinants of organizational commitment. *Human Relations, 41*(1), 467–482.

Oddou, G., Osland, J. S., & Blakeney, R. N. (2009). Repatriating knowledge: Variables influencing the "transfer" process. *Journal of International Business Studies, 40*(1), 181–199.

Paik, Y., Segaud, B., & Malinowski, C. (2002). How to improve repatriation management: Are motivations and expectations congruent between the company and expatriates? *International Journal of Manpower, 23*(7), 635–648.

Rego, A., & Cunha, M. P. (2008). Perceptions of authentizotic climates and employee happiness: Pathways to individual performance? *Journal of Business Research, 61*(7), 739–752.

Reichers, A. (1985). A review and reconceptualization of organizational commitment. *Academy of Management Review, 10*(1), 465–476.

Stemler, S. (2001). An introduction to content analysis. *ERIC Digest*. Available at http://www.ericdigests.org/2002-2/content.htm. Accessed 3 May 2012.

Stroh, L. (1995). Predicting turnover among repatriates: Can organizations affect retention rates?. *The International Journal of Human Resource Management*, *6*(2), 443–456.

Stroh, L. K., Gregersen, H. B., & Black, J. S. (1998). Closing the gap: Expectations versus reality among repatriates. *Journal of World Business, 33*(2), 111–124.

Tung, R. L. (1998). American expatriates abroad: From neophytes to cosmopolitans. *Journal of Business, 33*(2), 125–144.

Turner Parish, J., Cadwallader, S., & Busch, P. (2008). Want to, need to, ought to: employee commitment to organizational change. *Journal of Organizational Change Management, 21*(1), 32–52.

Vidal, M. E. S., Valle, R. S., & Aragón, M. I. B. (2007). The adjustment process of Spanish repatriates: A case study. *International Journal of Human Resource Management, 18*(8), 1396–1417.

Weiner, Y. (1982). Commitment in organizations: A normative view. *Academy of Management Review, 7*(1), 418–428.

16

Challenges in Employee Engagement in Emerging Economies

Arun Sacher and Ankur Lal

Introduction

One of the key determinants of success for any organization is the engagement level of its employees. The increasing emphasis on employee engagement in organizations across the globe is justified as it not only contributes to employee retention and productivity, but also directly impacts a company's reputation and customer satisfaction (Shriram, 2012). Various other researches, such as Kular, Gatenby, Rees, Soane, and Truss (2008); May, Gilson, & Harter (2004); Schaufeli & Bakker (2004); Strümpfer (2003), assert that the topic of employee engagement fascinates the academicians, researchers, and practitioners alike.

A. Sacher (✉)
SRM University, Sonepat, India
e-mail: arunsacher123@googlemail.com

A. Lal
Amity University, Noida, India

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_16

According to a research report by Blessing White (2013), employee engagement is seen from many perspectives and most often, is also equated with job satisfaction. Kular et al. (2008) posit in their study that some researchers (Baumruk, 2004; Richman, 2006; Shaw, 2005) define employee engagement in terms of their emotional and intellectual commitment to the organization and others like Frank, Finnegan, and Taylor (2004) describe it as the amount of discretionary effort exhibited by employees in their job.

Despite the absence of a universal definition of employee engagement, its multi-faceted nature is acknowledged in the present time (Kular et al., 2008). Researchers like Kahn (1990) have tried to highlight the various facets of employee engagement by explaining it in terms of an employee's physical, cognitive, and psychological make-up vis-à-vis his/her work role. Kahn's view is considered to be highly influential as it not only introduced engagement as 'psychological presence' of an employee in her role but also became the base for many future researches. He believed that engagement is about 'harnessing' one's complete self—that includes physical, psychological, and cognitive structure of one's personality to the organizational role. He emphasized that an employee's feelings, thinking, and attitude (positive/negative) about his/her organization, the leader, and the working conditions are of utmost importance in terms of his/her engagement. Kahn's (1990) views also stress upon the physical aspect of one's job performance.

Along similar lines, a Blessing White's model (2013) focuses on two important factors, that is, 'individual's contribution to the company's success' and their 'personal satisfaction in their role'. According to the model, as shown below, full engagement represents an alignment of maximum jab satisfaction ('I like my work and do it well') with maximum job contribution ('I help achieve the goals of my organization') (Fig. 16.1).

Further, a report by KPMG (2012) asserts the role of employee engagement as a measure of employee attachment and relationship with the organization, working culture, their role, and relationship with colleagues. Although the impact of employee engagement is varied and deep, an engaged employee is expected to be attentive to his work and duties, which in turn brings a positive change in the productivity of the

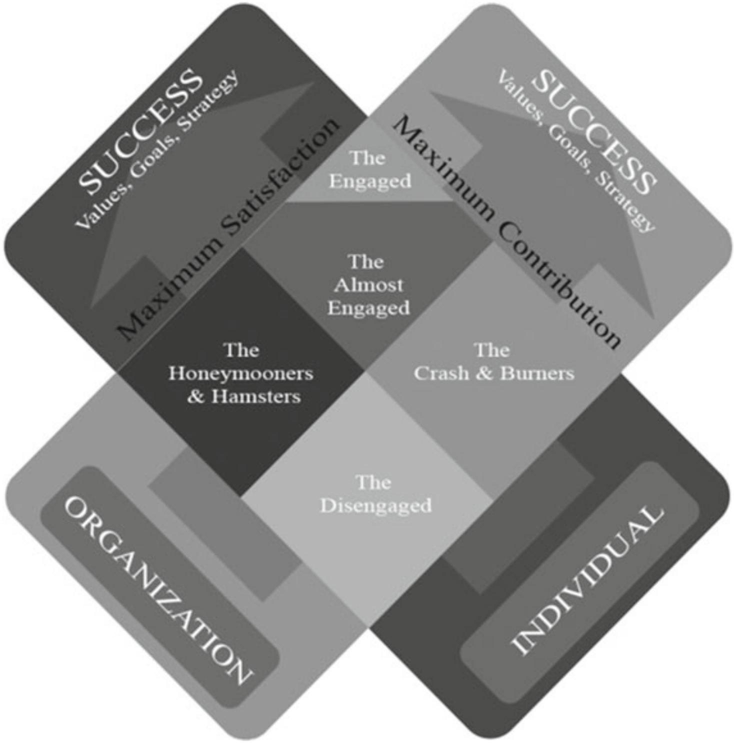


Fig. 16.1 Blessing White (2013) model of engagement

employee and the organization. As suggested by AON Hewitt in their report (2012), the engagement improvement plans can address employee motivation, behavior, productivity, and subsequently business results.

From the above discussion, we observe that the common thread running in the various approaches and definitions of employee engagement is the psychological as well as attitudinal assessment and response of an employee toward his organization, its leadership, and the various allied work factors like culture, colleagues, role, environment, and so on. Also the concept of employee engagement reiterates the underlying assumption that employees are the building blocks of any organization and their engagement and satisfaction level drive the success story of an organization. An engaged employee, and an engaged team in turn, contributes to the competitive advantages of the organization.

Objective

1. To review the employee engagement of emerging economies—BRICS nations
2. To discuss the ways to improve global and regional employee engagement practices

Review of Emerging Economies

Decline in Employee Engagement in the Last Decade

There is an overall downfall in the engagement level of employees and in fact, organizations are experiencing that there is a 'deepening disengagement' among employees in the last decade (Bates, 2004; Richman, 2006). As indicated by Kular et al. (2008) in their study, engagement of employees has become a great concern for organizations at an international level. They identified three discrete groups of employees: engaged, non-engaged, and actively disengaged, on the basis of a study by Gallup. The findings of the Gallup study, as proposed by Kular et al. (2008), indicated that the majority (63 %) of employees were 'non-engaged', 17 % were 'engaged', whereas remaining 20 % were 'actively disengaged'. As indicated by Seijts and Crim (2006), the Towers Perrin 2005 Global Workforce Survey exhibits similar global trends. This survey indicated that only a small percentage of the surveyed employees (14 %) were highly engaged in their job, followed by 62 % as moderately engaged, and 24 % reported that they are actively disengaged.

Recuperating from Decline: Rising Employee Engagement of Emerging Economies

In their research report, AON Hewitt (2012) suggests that out of every ten employees in the world, four employees are not engaged. Providing insight into global employee engagement trends, the report concludes that 'engagement levels are stabilizing globally but shifting across regions'. The overall stability in the global numbers of employee engagement is evident from the fact that the engagement levels remained almost the same even during economic crisis. One would have expected a sharp decline but there was a rise of two points in the engagement levels from 56 % in 2010 to 58 % in 2011 (Fig. 16.2).

The report most importantly highlights that engagement level varies by region. As seen from the graph, there is a considerable growth in the engagement levels of the employees in the Asia-Pacific region. The scores of this region rose by three points and were 58 % in 2011 as against 55 % in 2010. The accelerating scores of this region contribute to the overall rise in the global scores of employee engagement.

Similarly, a survey by Effectory (2012a) reports that despite the turbulent global business environment—due to the recent recession—the average score on engagement, worldwide, is 7.2. Although there is uncertainty, employees are showing that they are engaged in their work (Table 16.1 shows a part of the findings of this survey).

Reiterating the rising region-wise difference in employee engagement, the report indicates that emerging economies like Bulgaria, Mexico, and India stand out in terms of engagement.

Along similar lines, a research update by Blessing White (2013) compared the engagement level of different regions for years 2011 and 2012, as shown in Fig. 16.3. The comparison concludes that although there was no reduction in the engagement scores of any region, the growth of

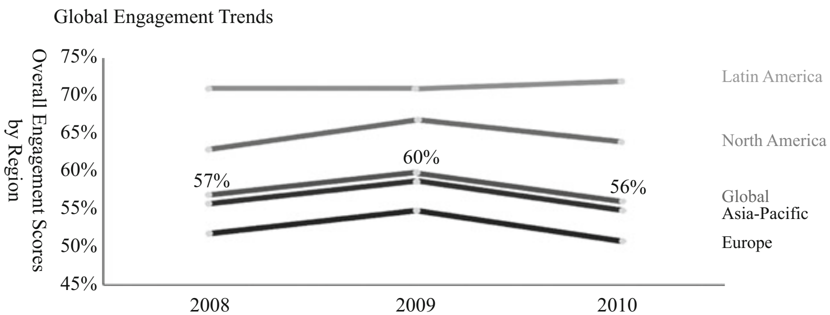


Fig. 16.2 Global engagement trends

Table 16.1 Highlighting some findings

	Engagement	Satisfaction	Leadership	Willingness to change	Role clarity
Worldwide avg.	7.2	6.6	6.2	7.1	5.9
North America	7.5	7	6.6	7.4	6.6
South America	7.7	6.9	6.5	7.6	6.7
Europe	7.3	6.6	6.3	7.1	6
Africa	7.5	6.4	6.2	7.4	5.5
Asia	6.8	6.3	6	6.7	5.3
Australia	7.3	6.5	6.3	7.3	5.7

Adapted from Effectory (2012a) survey

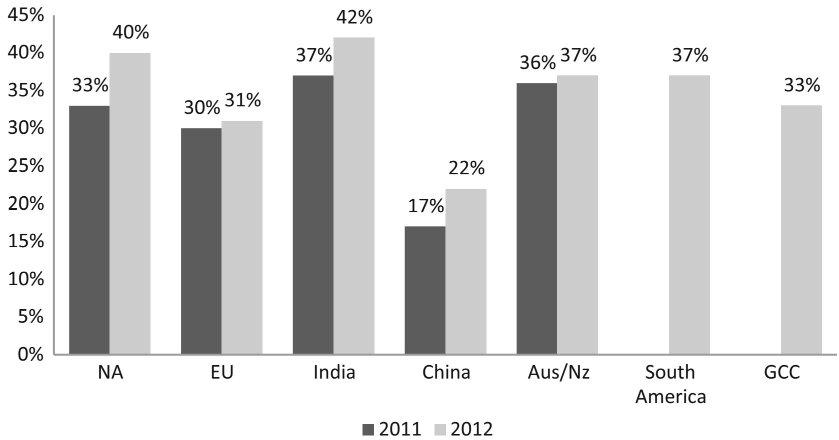


Fig. 16.3 Region-wise comparison of engagement for 2011 and 2012

developed regions such as Europe and Australia/New Zealand was ‘essentially flat’. On the other hand, the engagement levels of regions such as North America, India, and China exhibited a significant increase.

Further, the report says that India has the highest levels of engagement.

Among other emerging economies, Mexico and Brazil also have higher percentages of engaged employees (Seijts & Crim, 2006).

According to Shriram (2012), there exists a significant difference between the engagement levels of developing and developed economies, with developing economies having better engagement scores. This indicates that an employee of a developing nation will be more engaged than his counterpart of a developed economy and he also suggests that developing economies also seem to 'value the non-traditional elements' better. His study was based on the Towers Watson, 2010 Global Workforce Study, which found that 'even after controlling for demographic (e.g., age, gender and grade) and macroeconomic factors (e.g., gross domestic product, growth and unemployment rates), workers in emerging economies such as Brazil, China and India are more engaged with their jobs than workers in developed markets', as shown in Fig. 16.4.

From the above review of literature and research presentations of various consultancy organizations, we can say that emerging economies are experiencing a sharp increase in their level of employee engagement and thus contributing to the stability of the global index.

Employee Engagement in Emerging Markets: Status in BRICS

As per a Deloitte report on emerging economies (2011), 'Prior to the recession, the emerging economies of China, India, Brazil, and others represented the growth markets of the future. After the recession, that future has arrived'. Emerging markets are the growth engines of today's world. The economy in these countries is growing; other factors such as favorable demographics (Shriram 2012), abundance of low-cost labor and natural resources, expansion of local competitors (Fidelity, 2012), and so on make these economies attractive destinations for expansion of business. Price Water House Coopers (2012) in their report say, 'While advanced economies in the West face an era of heightened uncertainty, escalating debt, and aging populations, emerging and fast-growth markets seem to be following a virtuous circle upward—despite their own sets of challenges—as they invest their newfound gains in education, technology, and infrastructure'.

Collins (2010) indicates that the emerging markets appreciate the importance of energizing their workforce and upskilling their managers. These economies realize and make employee engagement their focus as they perceive it as the differentiating factor in delivering future business success.

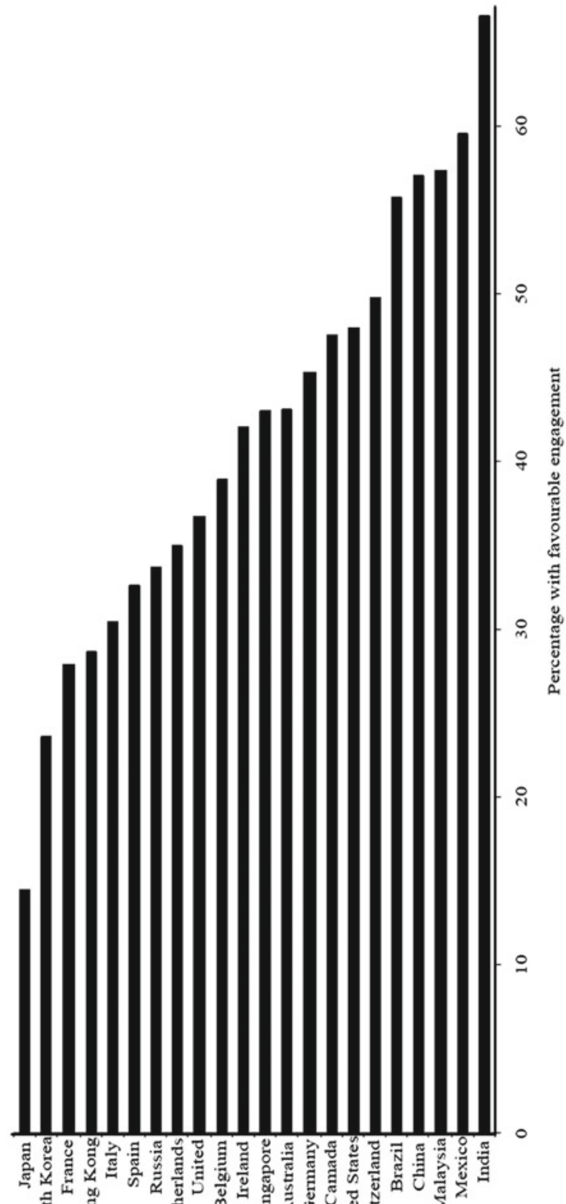


Fig. 16.4 Countries with favorable engagement

The classification of emerging markets has been dynamic. The most famous nomenclature for these nations is 'BRICS' (Brazil, Russia, India and China, with South Africa added in 2010) (O'Neill, 2001; Goldman Sachs, 2013). Furtherance of analysis in the classification system is now pointing at the 11 '3G' (Global Growth Generators) economies, that is, Bangladesh, China, Egypt, India, Indonesia, Iraq, Mongolia, Nigeria, Philippines, Sri Lanka, and Vietnam (Buiter and Rahbari, 2012).

Employee Engagement in India and Brazil

Keeping in view the BRICS classification, employee engagement levels in India and Brazil are the highest in the world, with 'engagement indices' of 73 % and 65 %, respectively (Management Issues, 2009). According to Global Employee Engagement Index, as given by Effectory (2013), Indian employees top the chart of employee engagement of the BRICS countries. The index suggests that the general work perception score at the global level is 6.6 and the Indian score of 7.3 is better than the global average. This high score is evident of the fact that the commitment of Indian employees to their organization is high and the report further highlights that 'willingness to change' and 'customer orientation' are also found to be significantly high in Indian employees. India's strong positioning in terms of employee engagement is further supported by a report by Blessing White (2011). It highlights that India fared better than the other regions surveyed; with 37 % engaged and 12 % disengaged, India led Australia/New Zealand, North America, Europe, Southeast Asia, and China in terms of engagement levels (Mellina, 2012). Another study by Farndale, Hailey, Kelliher, and Veldhoven, (2011) comparing the engagement level of India, China/Hong Kong, and UK/Netherlands—as can be seen from Table 16.2—found that the engagement scores of India are the highest. India also reported to be having high levels of 'job resources' and 'job/organizational demands'.

Comparing the employee engagement of India with other developed nations, Collins (2010) exemplifies that TATA, a leading Indian company, is placing great emphasis on training their managers, developing their listening skills and showing empathy toward their staff. Collins asserts that this could be compared in direct contrast to Telecom France

Table 16.2 Comparison of engagement of three countries

Employee engagement	UK/Netherlands	China/Hong Kong	India
Job state engagement	3	2	1
Job behavioral—initiative	2	2	1
Job behavioral—active learning	3	2	1
Org. state—affective commitment	1	2	1
Org. state—organization satisfaction	1	2	2
Org. behavioral—citizenship behavior	2	3	1

Adapted from Farndale, Hailey, Kelliher, and Veldhoven (2011)
(As per Farndale et al. (2011), 1 = highest mean, 2 = 2nd highest mean, 3 = 3rd highest mean)

and EDF Energy in the developed world, where suicide rates are high among their employees attributed to changes in work rosters and lack of employee engagement. Collins highlights that the developed countries' approach is reactive as opposed to the proactive approach by companies in the emerging economies.

However, with the background that engaged employees stay with the organization, sVorhauser-Smith (2012) questions India's employee engagement, as the attrition rate in India is 20–30 % (50 % in industries such as IT). The study highlights that '54% of Indian workers are seriously considering leaving their jobs, and that figure spikes to 66% in the 16–24 year age bracket'.

As highlighted by Bansal (2012), Jim Clifton, CEO of Gallup, also shares similar negative views on employee engagement in India and warns that Indian workplaces are going downhill. Furthering his views, Clifton opines that only 8 % people in India are engaged, positive, and thrilled about their jobs and 30 % are miserable and actively disengaged (Bansal, 2012). Hence, a mixed picture about the state of employee engagement in India is obtained from these researches, strengthening the improvement in practices and need for further research.

The scores of Brazil follow India's top position in employee engagement. According to a research report by International Survey Research (2004), countries differ on the basis of engagement levels. The case of developing countries, such as Brazil, as highlighted in the survey, is much better than many high-income economies in terms of employee engagement (Farndale et al., 2011).

Mimicking the same trend, Towers Perrin 2005 Global Workforce Survey concludes that employee engagement in countries such as Mexico and Brazil is accelerating (Seijts & Crim, 2006). According to AON Hewitt (2011), the economic recession had impacted both the developing nations and developed nations equally, or may be more due to their economic backwardness, but the growth charted by these countries in the post-crisis era is extremely high. Markets like Brazil, Chile, and Peru have emerged out of the crisis with resilience and the recovery is fast and sustainable as compared to the high-income economies. The report further adds that the engagement level of employees of these countries is also higher than that of developed countries. As per the report,

> 'In Latin America, career opportunities, recognition, brand alignment, and pay have been among the top five engagement drivers for three consecutive years. Although many employers took some measures to weather the economic storm, these measures were not as drastic as in other regions. This may explain why the average engagement levels in the region didn't experience the declines observed in other markets'.

Taking the specific case of Latin America, 'recognition' was found to be an important contributor in the improvement of an employee's engagement. The report highlights that employees of Brazil were found to be talking and expressing freely about their recognition in the organization. They preferred that they should be 'recognized according to their contributions—through differentiated rewards, opportunities for growth, and feedback from their manager'.

However, the situation is not the same in other emerging economies. The high level of employee engagement in India and Brazil, as shown by studies mentioned above, is not replicated in rest of the BRICS nations (Russia, China, and South Africa) (Effectory 2012b, 2013).

Employee Engagement in China

China—having a very significant place in BRICS—has the most disengaged employees globally, as concluded by the 2010 employee engagement report by Blessing White. The report suggests that 29 % of employees there are fully disengaged; and only 1 in 6 (7 %) are actually engaged. As highlighted by Yu and Srinivasan (2013), Chinese workers were expected to exhibit a slight improvement in their engagement scores in the year 2012 as compared to the engagement scores of previous years. As summarized in Table 16.3, there is remarkable jump of 4 % points within a span of three years in terms of engaged employees in China. The numbers suggest that 2 % of Chinese employees were engaged in their jobs in 2009 and the numbers rose to 6 % in 2012. Despite the significant jump, the index indicates that the average number of engaged employees in China is far behind the global average. Additionally, prior Gallup research indicates that 'Chinese workers are among the least likely in Asia to see their job as ideal, suggesting that they are less likely to go above and beyond for their employer' (Yu & Srinivasan, 2013).

The global employee engagement index as given by Effectory (2013) also indicates that employee engagement in China is significantly lower than the world average. In their survey, the score obtained as a result of Chinese employees rating their overall work perception was 6.3. The obtained score, when compared to the global scores, was found to be much lower. Further, comparing it with India, the report asserts, 'India's emerging economy is further strengthened by the perception of work in the country. Chinese employees have become increasingly more critical; they are standing up for themselves more and more. They ask for better working conditions and better compensation. That image is reflected in the scores of this survey' (Effectory, 2013).

Analyzing the low engagement level in China, a study by Farndale et al. (2011) talks about the cultural difference between countries like India, China, the USA, and so on. Highlighting the views of Hofstede (1980), Farndale et al. (2011) argue that the need for organizational structure, especially 'hierarchies' in the organization is influenced by the cultural make-up of that particular society. As known, cultures like India or China are not individualistic as is the case in most of the countries of

Table 16.3 Change in engagement in China from 2009 to 2012

Employee category	2009	2012	Change (percent points)
Engaged employees	2 %	6 %	+4
Not engaged employees	67 %	68 %	+1
Actively disengaged employees	31 %	26 %	−5

Adapted from Yu and Srinivasan (2013)

the West. In these eastern countries, 'groups' are more important in the society. The study aptly puts forward that these cultural contrasts have a genuine and lasting impact on human behavior in general and at the organizational level. Farndale et al. (2011) further suggests that the ethos is expected to 'influence the way employees respond to the organisations and managers they work for, and the systems in place to manage their performance'. They say that cultural and societal factors play a crucial role in determining the engagement levels of employees of that particular culture. In the case of China, the study emphasizes the role of 'organizational hierarchies' and 'group'-based structure as the likely reason for low engagement scores.

Along similar lines, another study highlights the role of culture and society in influencing the level of engagement of employees. This study once again sheds light on the 'hierarchical' structure of Chinese organizations. In the case of countries like United Kingdom and Netherlands, organizations do not follow any hierarchy, rather they believe in 'flatter' structure which is appropriate for better communications among employees and with the seniors too. As everyone in the organization is on the same platform, it becomes very easy for managers to take care of the needs of the employees and therefore give a regular boost to their engagement level. On the other hand, as the study puts forward, Chinese managers by virtue of their strict organizational hierarchy are not able to actively engage with their employees. The study further highlights as to how organizations in the Western countries involve employees from all levels in the decision-making process and how they gather constructive feedback from employees, which seems to be not taking place in China. As indicated in the study, 'It can be argued that Western society is conducive to an environment in which employees are more willing to voice their views in an open and often critical manner than is the case in hierarchical societies such as China' (Asia Research, 2012).

The case of China and its low engagement levels has been a topic of research for long and most of the studies indicate that the cultural and sociological set-up the of the country influences the same.

Employee Engagement in Russia

Russia is among the worst scoring countries in terms of employee engagement, as concluded by Effectory's 2012 Global Employee Engagement Index. Effectory (2012b) interprets the index and highlights 'loyalty', 'motivation', and 'retention' as the core issues for Russia. The index gives the information that employees in Russia are less motivated as compared to their counterparts in the region and do not display the need to be loyal to the organization. As a result of lower loyalty to the organization, Russia is also struggling with high attrition levels as is the case of India. In both these countries, employees may be discharging their duties well as they seem to be aware of the expectations of the employer but they are not continuing in the same organization for a longer period. Although the issue of 'retention of employees' is the same in both the countries, that is, India and Russia, the interpretation of index, as given by Effectory (2012b) mentions that the reasons differ in both cases. The index opines that the issue of 'power' may be the driving force and says that 'it seems that the power in India lies with employees, whereas in Russia the power lies with the employer'.

Another study resonates the criticality of power in case of Russian organizations. As per a study by Chartered Institute of Personnel and Development (CIPD) (2013), the culture within Russian organizations tends to be dominated by power relations. With the lack of innovation in management practice and inadequate execution of policies, Russia has a highly autocratic culture with little understanding of employee engagement or the importance of managing performance or talent. Furthermore, CIPD concludes that all power is bestowed to the senior managers and it is felt that Russian employees are not yet ready to 'self-appraise'—they need to be told what to do.

The power struggle in Russian culture resonates in its organizations too and is assigned as the foremost factor behind its poor level of employee engagement.

Employee Engagement in South Africa

Employee engagement in the last and newest member of BRICS, South Africa, is not very promising. Cawe, M. (2006) categorizes employee engagement in this country to be a 'challenge' due to various inside and outside forces. South Africa obtained the lowest employee retention rate of 4.6 in the Effectory Global Employee Engagement Index (2012b). High level of attrition leads to poor engagement of employees or vice versa in this region. Researchers suggest that the reason behind poor employee retention could be the result of poor work conditions (Vilet, 2012), lack of loyalty, satisfaction, role clarity, or efficiency (Effectory, 2012b). All of these organizational and other factors add up to disengagement of employees. According to Cawe, M. (2006), there are numerous prevailing forces existing in South Africa which make employee engagement quite a challenge, such as 'depth of leadership skills in companies, scarcity of key talent, labor conflicts, and slow pace of transformation and outside work issues like high rate of poverty, unemployment and lack of proper education', all have an effect on employee engagement. Another perspective highlighted by Effectory (2012b) is the flexibility of South African employees. It is suggested in the research that the engagement level of these employees may show improvement if their willingness to change is tapped properly. Harnessing their flexibility may give them a feeling of being important and bring about a change in their engagement level. The study resonates the previous findings of poor facilities in the country and comments that 'It seems that the South African workforce is prepared to go the extra mile, but the facilities, infrastructure and so on make it difficult to achieve excellent performance'.

Hence, a focused analysis of the BRICS nations in terms of employee engagement highlights that employee engagement is not homogeneous within the group. While India and Brazil are topping the list and stabilizing the global scores of employee engagement, Russia and South Africa stand out with very low scores. China's position seems blurred; although its scores are improving in the recent past, the overall index is still low. These researches clearly demonstrate what Kular et al. (2008) commented in their research 'that one size does not fit all'. Every country's socio-cultural, political, and economic conditions are different and so are the attitude and behavior of their employees. Employee engagement is a sensitive issue and highly influenced by the psychology of employees and the socio-cultural structure of the region. Motivating the employees, getting them engaged in their work and to the organization is individualistic and highly dependent on how we understand the society and the need of the employees.

Improving Global and Regional Employee Engagement Practices

According to a report by AON Hewitt (2012), employee engagement is a significant contributor in improving the overall performance of the organization. Engaged employees provide great support and comfort to the organization when it is going through turbulent times. Greater loyalty and high levels of engagement help the organization focus and handle any short-term crisis without worrying about the attrition of its employees. Further, the study highlights the importance of employee engagement for 'longer-term business performance' and in improving and sustaining the competitive advantage. As suggested in the study, 'The companies that get engagement "right" will enjoy a source of competitive advantage in talent strategy and business results that is hard for others to replicate'.

The report by AON Hewitt (2012) talks about six drivers of engagement, that is, people, work/motivation, opportunities, total reward, procedures, and quality of life/values. Keeping in view the grave region-wise difference in engagement scores, the report by AON Hewitt (2012) emphasizes on region-wise work on the engagement drivers as shown in Table 16.4. The table indicating the top engagement drivers for the year 2011 demonstrates that employees of Asia-Pacific and Latin American regions seem to be concerned about their 'pay' and 'career aspirations'. It indicates that money is not the only driver of engagement for these employees, rather career development is equally important. These employees feel engaged to the organization only when their basic need of money and the next level need of a better career are guaranteed by the organization. On the other hand, regions of Europe and North America are dominated by employees with concern about 'organizational reputation'. Keeping in view the economic forwardness and other infrastructural facilities in these countries, it becomes quite evident that employee engagement is governed by factors like reputation of the firm, employee recognition in the organization, communication within the organization, and so on.

A different set of engagement drivers have been found to be working for China (Asia Research, 2012). China is undergoing a massive change where the base of its economy is shifting. As suggested by Yu and Srinivasan (2013), the earlier pillars of the Chinese economy were

Table 16.4 2011 Engagement drivers for four countries

2011 Regional Drivers	Asia-Pacific	Europe	Latin America	North America
Career opportunities	1	1	2	1
Recognition	3	5	1	4
Organizational reputation	–	2	–	3
Communication	–	4	3	5
Managing performance	–	–	–	2
Pay	4	–	5	–
Innovation	–	3	–	–
Brand alignment	–	–	–	–
People/HR practices	2	–	–	–
Career aspiration	5	–	4	–

Adapted from AON Hewitt survey (2012)
{As per AON Hewitt (2012), 5 = most important, 1 = least important}

'low-value added, low-skill manufacturing jobs', which are being transformed into 'knowledge-intensive and innovation-oriented high-skill jobs'. Due to this paradigm shift, organizations are facing many challenges in the form of employee retention, performance management of the employees, and enhancing the engagement level of employees. In the current scenario, as the study highlights, Chinese organizations may be seen struggling to retain their most talented employees and at the same time, make efforts to maximize the performance of their existing employees. Having understood the relevance of a satisfied and engaged employee, the aim of these organizations is to assemble a workforce which will help them gain competitive advantage. The Chinese organizations can get some guidance by making use of relevant employee researches/surveys. As suggested by Asia Research Online (2012), 'these researches can be used to develop a strategy for building a committed workforce who will contribute to the well-being and future prosperity of the company'.

Rothmann and Rothmann (2010) talk about specific steps that an organization may take to improve their employee engagement. They emphasize that the plan for increasing engagement should take a number of issues related to role of the employee in the organization, his/her relationships with peers and seniors, his overall feeling toward the job, and so on into account. Taking the specific case of South Africa, they talked about three steps toward the betterment of employee engagement. The first step is to enable the employees find meaning in the role assigned to them. They emphasized that the organizations should ensure that the role given to the employees matches their attributes and qualifications; and provides them variety in their tasks, opportunity to work independently, and enough opportunities to learn and grow. The second step, as discussed in the study, deals with organizational factors such as clear and unambiguous communication within the organization, and involving employees in various types of decision-making. It also emphasizes that organizations need to ensure that information is disseminated in the organization in a proper manner, employees are clear as to what is expected out of them, and they enjoy a cordial relationship with seniors and peers. Thirdly, the researchers talk about the 'advancement opportunities (remuneration, promotion and training)' that should be provided to the employees in order to improve their level of engagement.

Similarly, for Russia, studies indicate that inherent enthusiasm and flexibility of Russian people may be harnessed to improve employee engagement.

As discussed earlier, culture and society play a major role in defining the identity of an organization in the specific region and the engagement level of its employees. In an article, Ganguly (2012) interprets Grant's (2009) notions and posits as to how the rich cultural heritage of India can be utilized in promoting employee engagement in the country. He believes that India's high spirituality quotient can play a vital role in corporate culture. India can show the way by integrating its inherent spirituality with everyday work–life rather than keeping them in separate compartments. This gives people a sense of social purpose. It helps them reach their full potential as workers and managers.

There are few studies that have tried to analyze the reasons behind the low levels of employee engagement in organizations. Study by Farndale et al. (2011) talks about few such reasons that resonate with the findings of other researchers too, such as those of Rothmann and Rothmann (2010). The prime reasons as highlighted in these studies revolve around organizational negligence in acknowledging the significance of an employee's contribution in the functioning of the organization. Majority of the organizations do not let employees participate in the process of decision-making in the organization. Employees are just supposed to implement the decision made by the higher authorities and have no say in decision-making. Further, organizational unwillingness to work on improving communication, working conditions, role-related ambiguities, and relationship with seniors and colleagues are some of the reasons indicated by these studies. Farndale et al. (2011) are able to put forward a novel approach to the idea of understanding employee engagement. They believe that the engagement level of the higher authorities and the reporting manager are critical drivers of an employee's engagement. Whether an employee will be engaged or disengaged is highly influenced by the kind of manager he/she has. Managers are a role-model to their subordinates and if they exhibit high levels of satisfaction and engagement with the organization, the employee is subtly influenced to change in his attitude. They argue that the power and impact of a manager on his/her subordinates should be harnessed in order to increase the employee's level of engagement.

As suggested by Kock (2010), the role of managers in the overall development of an employee and in improving his engagement level is paramount. His views coincide with those of Farndale et al. (2011), where both studies emphasize that the relationship between a manager and his subordinate needs to be very strong, supportive, and empowering for the subordinate. According to Kock (2010), managers need to acquire the role of a coach for his subordinate where the long-term as well as short-term needs of the subordinate are taken care of. He further posits that the relationship has to be 'an empowering relationship that facilitates the creation of meaningful, challenging work that tests employee's resourcefulness'. Once again, it is highlighted in the study that rising attrition rate is somewhat indicative of lowered employee engagement. Hence, 'employee retention' is one of the prime duties of a manger, and the study proposes use of validated instruments to assess engagement level. The analysis of other factors influencing employee engagement coupled with the results of such instruments may help the managers get a clear picture of the factors that influence the engagement level of the employees of their particular organization. Further, Kock (2010) highlights that compiling of such information may be useful for the managers in order to assess the 'degree of connectedness among employees to their jobs and the organization' which in turn can 'provide a guide to identifying measures for retaining competencies and experience'.

Hence, identification of and uplifting the regional drivers of employee engagement—indicating country-specific work—and an overall improvement in management is warranted in today's time, in order to have global as well as regional improvement in employee engagement.

Discussion and Conclusion

This study aims to describe the status of employee engagement in the emerging economies, with special emphasis on BRICS nations. In order to achieve the objective of the research, a review of the available literature was conducted.

This literature review reveals that employee engagement has been defined in different ways. Researchers have taken varied approaches and views in describing the concept of 'employee engagement'. Reiterating the findings of Kahn (1990), the present study also comes to the conclusion that employee engagement is a 'multi-faceted construct with no single definition'. The varied perspectives on the subject matter make the construct complex and hence, assessment and improvement become an issue for the organizations.

Employee engagement is responsible for improving the overall organizational performance and there are numerous examples of increased corporate profitability and organizational success due to increased employee engagement (Farndale et al., 2011; Shriram, 2012). With the increase in research interest in this area (Kular et al., 2008), academicians and practitioners are studying employee engagement worldwide and discovering novel practices. Several researchers have highlighted the cognitive, psychological, physical, and socio-cultural aspects of employee engagement (Kahn, 1990; Truss et al., 2006).

Apart from the universal factors like rewards, senior management, motivation, opportunities, driving employee engagement worldwide (AON Hewitt, 2012; Blessing White, 2013), other factors like global business environment also influence employee engagement (Kular et al., 2008). The recent economic recession and the economic volatility in the last decade have brought down the levels of employee engagement (AON Hewitt, 2012; Kular et al., 2008; KPMG, 2012). With the start of this decade, global scores seemed to stabilize; reason being the soaring regional employee engagement scores (AON Hewitt, 2012; Blessing White, 2013; Seijts & Crim, 2006; Effectory, 2013). The present study has discussed this trend in detail.

This regional strengthening of employee engagement was made possible due to the emergence of developing markets in the global business scenario. The low-cost labor market, abundance of natural resources, young working population, and many other factors are making these emerging markets extremely lucrative for the multinationals and providing these economies their space in the global economic map (Fidelity, 2012; PWC, 2012; Shriram, 2012).

The emerging economies such as BRICS are a mixed bag in terms of employee engagement. While India and Brazil have high scores (Blessing White Research, 2011; Effectory, 2013; Farndale et al., 2011), China, Russia, and South Africa deal with their low scores and disengaged staff (Effectory, 2012b, 2013; CIPD, 2013; Yu & Srinivasan, 2013; Vilet, 2012). However, India, in the background of high attrition level, is facing low employee engagement sporadically (Bansal, 2012; Vorhauser-Smith, 2012).

Review of the literature further indicates that the imbalance in global and regional scores of employee engagement needs special attention. Negating the one-size-fits-all approach (Farndale et al., 2011), organizations need to understand the key drivers—both in general and specific to the workforce. A deep understanding of the volatility in global economic conditions and its impact on the workforce is required and appropriate innovative measures need to be implemented.

Further, the review highlights researches that are region-specific and identify regional drivers of employee engagement—such as pay for Latin America and Asia-Pacific, reputation of the organization for European and North American employees. These regional drivers need to be known and understood while deciding for the employee engagement practices (AON Hewitt, 2012).

Reviewing the research, the emerging economies can be called as the 'global stabilizers', with tremendous scope for future research and innovative practices backed by their favorable demographics, location, and the general 'hunger' for growth.

Limitations of the Study

Despite highlighting meaningful insights into employee engagement in emerging economies, the present study has its own limitations. It may be noted that the secondary data used for the study may not be representative and may have provided a biased picture. Also, the negative picture of developed nations in terms of employee engagement may be a result of few 'gaps' in the availability of such literature. The limitations of secondary data—incomplete, redundant, outdated, unreliable, vague, and ambiguous data—could not be avoided in this research.

References

AON Hewitt. (2011). *Trends in global employee engagement*. Available from http://www.aon.com. Accessed 3 Mar 2013.

AON Hewitt. (2012). *2012 trends in global employee engagement*. Available from http://www.aon.com. Accessed 3 Mar 2013.

Asia Research. (2012, February). *The art of employee engagement in China*. Available from http://asiaresearch.net. Accessed 1 Mar 2013.

Bansal, S. (2012). *Jim Clifton: Only 8% Indians are positive about their jobs*. Available from http://www.livemint.com. Published on April 30, 2012. Accessed 20 Feb 2013.

Bates, S. (2004). Getting engaged. *HR Magazine, 49*(2), 44–51.

Baumruk, R. (2004). The missing link: The role of employee engagement in business success. *Workspan, 47*(12), 48–52.

Blessing White. (2013). *Employee engagement research update January 2013, Beyond numbers: A practical approach for individuals, managers and executives*. Available from http://blessingwhite.com/research. Accessed 2 Mar 2013.

Buiter, W.H. & Rahbari, E. (2012). Debt of nations: Mr. Micawber's vindication: Causes and consequences of excessive debt. Citi GPS, Global Perspectives & Solutions, November.

Cawe, M. (2006). *Factors contributing to employee engagement in South Africa.* Research report for Masters in Human Resources Management, Johannesburg, University of Witwatersrand.

CIPD. (2013). *Roundtable event with HR leaders from Moscow*. www.cipd.co.uk. Accessed 2 Feb 2013.

Collins, J. (2010). *Emerging economies ahead in employee engagement*. Available from http://www.sunzu.com/articles/emerging-economies-ahead-in-employee-engagement-142970/. Published on January 20, 2010. Accessed 1 Mar 2013.

Deloitte. (2011). *Emerging markets: The front line for growth and talent*. Available from http://deloitte.com. Human Capital Trends 2011, New York, USA: Deloitte. Accessed 5 Mar 2013.

Effectory. (2012a). *Interpretation of Effectory, the employee survey expert*. Available from http://www.employee-engagement-index.com. Accessed 3 Mar 2013.

Effectory. (2012b). *Work perception in international perspective 2011–2012*. Report based on Global Employee Engagement Index, Amsterdam, The Netherlands- Effectory.

Effectory. (2013). *Indian employees most positive of all the BRIC countries*. Available from http://www.employee-engagement-index.com. Published on February 14, 2013. Accessed 3 Mar 2013.

Farndale, E., Hailey, V. H., Kelliher, C., & Veldhoven, M. V. (2011). *A study of the link between performance management and employee engagement in western multinational corporations operating across India and China*. Report, Alexandria, Virginia: SHRM Foundation.

Fidelity. (2012). *Emerging markets insight*. Available from www.fidelityworldwideinvestment.com. Accessed 2 Mar 2013.

Frank, F. D., Finnegan, R. P., & Taylor, C. R. (2004). The race for talent: Retaining and engaging workers in the 21st century. *Human Resource Planning, 27*(3), 12–25.

Ganguly, D. (2012). *What India could teach the world about employee engagement*. Available from http://articles.economictimes.indiatimes.com, ET Bureau, Published on August 17, 2012, 06.48AM IST. Accessed 1 Mar 2013.

Goldman Sachs. (2013). *Next 11: It's time to redefine emerging markets*. Available from www.goldmansachs.com. Accessed 5 Mar 2013.

Grant, R. (2009). *Contemporary strategy analysis* (7th ed.). New Jersey: John Wiley and Sons Inc.

Hofstede, G. (1980). *Culture's consequences. International differences in work-related values*. Thousand Oaks: Sage.

Internatio nal Survey Research. (2004). Available from www.isrsurveys.com. Accessed 24 Feb 2013.

Kahn, W. A. (1990). Psychological conditions of personal engagement and disengagement at work. *Academy of Management Journal, 33*(4), 692–724.

Kock, R. (2010). *Improving employee engagement levels to weather the economic storm contributor*. Available from http://www.humanresourcesiq.com, Published on February 23, 2010, 12.00 AM EST. Accessed 3 Mar 2013.

KPMG. (2012). *The real value of engaged employees: New thinking on employee engagement strategies*. Available from http://kpmg.com, Business Leaders Survey 2012, United Kingdom: KPMG. Accessed 5 Mar 2013.

Kular, S., Gatenby, M., Rees, C., Soane, E., & Truss, K. (2008). *Employee engagement: A literature review* (Working paper series No. 19). London: Kingston Business School. Available from http://business.kingston.ac.uk/sites/default/files/6_rp_emplyengag.pdf.

Management Issues. (2009). *India and Brazil crack employee engagement*. http://www.management-issues.com, Published on April 20, 2009. Accessed 2 Mar 2013.

May, D. R., Gilson, R. L., & Harter, L. M. (2004). The psychological conditions of meaningfulness, safety and availability and the engagement of the human spirit at work. *Journal of Occupational and Organizational Psychology, 77*(1), 11–37.

Mellina, E. (2012). A real- world story of employee engagement. *Effective Executive, XV*(4), 17–20.

O'Neill, J. (2001). *Building better global economic BRICs* (Global Economics paper No. 66). New York: Goldman Sachs. Available from http://www.goldmansachs.com/our-thinking/archive/archive-pdfs/build-better-brics.pdf.

Pricewaterhousecoopers. (2012). *Emerging markets calling, growth beyond the comfort zone*. London: PWC, Issue 64. www.pwc.com. Accessed 5 Mar 2013.

Richman, A. (2006). Everyone wants an engaged workforce how can you create it? *Workspan, 49*(1), 36–39.

Rothmann, S., & Rothmann, S. (2010). Factors associated with employee engagement in South Africa. *SA Journal of Industrial Psychology, 36*(2), 1–12.

Schaufeli, W. B., & Bakker, A. B. (2004). Job demands, job resources and their relationship with burnout and engagement: A multi-sample study. *Journal of Organizational Behavior, 25*(3), 293–315.

Seijts, G. H., & Crim, D. (2006, March/April). What engages employees the most or the ten C's of employee engagement. *Ivey Business Journal*, pp. 1–5.

Shaw, K. (2005). An engagement strategy process for communicators. *Strategic Communication Management, 9*(3), 26–29.

Shriram, U. (2012). The many faces of your employees: Insights into the emerging markets workforce. *World Academy of Science, Engineering and Technology, 6*(4), 489–495.

Strümpfer, D. J. W. (2003). Resilience and burnout: A stitch that could save nine. *South African Journal of Psychology, 33*(2), 69–79.

Truss, C., Soane, E., Edwards, C., Wisdom, K., Croll, A., & Burnett, J. (2006). *Working life: Employee attitudes and engagement 2006*. Wimbledon: CIPD.

Vilet, J. (2012). *Employee engagement: Here's why it's a worldwide problem*. Available from http://www.eremedia.com/tlnt/employee-engagement-heres-why-its-a-problem-worldwide/, Published on November 26, 2012, 10:25 AM. Accessed 5 Mar 2013.

Vorhauser-Smith, S. (2012). *How to stop employee turnover in India*. Available from http://www.forbes.com/sites/sylviavorhausersmith/2012/07/02/how-to-stop-employee-turnover-in-india/#6676f2093a76. Accessed 1 Mar 2013.

Watson, T. (2010). *The new employment deal: How far, how fast and how enduring. Insights from Towers Watson's 2010 global workforce study* (p. 24). Washington, DC: Towers Watson.

Yu, D., & Srinivasan, R. (2013). *Employee engagement increases in China, but still very low*. Available from http://www.gallup.com/poll/160190/employee-engagement-increases-china-low.aspx, Published on February 20, 2013. Accessed 2 Mar 2013.

17

The Combined Use of Formal and Informal Ethics Training in the Indian IT Companies

Pratima Verma and Siddharth Mohapatra

Introduction

Business ethics has at best seen as an oxymoron by companies and never been of true concern for them. The widespread acceptance of Milton Friedman's ideology, that is, 'the business of business is business', has immensely influenced them as it is in alignment with their traditional motives of profit making. This ideology has been considered as the legitimate purpose of business, important to create shareholder value, and necessary to remain competitive, which have given enough reasons for corporations to ignore ethics. Interestingly, this very act of ignoring ethics has resulted in numerous scandals, briberies, dotcom bubbles-and-bursts, financial and accounting scams, economic instabilities, corruption, and so forth concerning corporations, which have forced them to realize that 'High Road Strategy' (Ghaye & Gunnarsson, 2009) is a better way of doing business as doing so espouses ethical and sound strategies for

P. Verma (✉) • S. Mohapatra
Alliance University, Bengaluru, India
e-mail: verma_pratima@yahoo.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_17

long-term sustainability and growth. They also realize the need to seriously consider the concept of 'social contract' by Rousseau (c.f. Gildin, 1983), which implies that contracts have obligations, opportunities, and advantages for both sides, involving business and society. This concern has permeated into the corporate world at all levels, and it is increasingly being accepted that operating ethically can indeed lead to good business in the long run. Companies with strong ethical values are associated with greater commitment to quality, customer loyalty, employee commitment, and profitability. Moreover, it has been observed that creating an organization that encourages exemplary conduct may be the best way to prevent damaging and damning misconducts (Paine, 1994). Business ethics is also considered as inevitable for organizations as it prescribes what we should be in terms of what we are as human beings (Pattan, 1984).

Furthermore, ethics programs have been critiqued for tightening the administrative control over a range of behaviors (Weaver, Trevino, & Cochran, 1999), which may weaken employees' ability and motivation to exercise their own moral judgments, especially in novel situations (Stansbury & Barry, 2007). It is opposed for being 'the specter of indoctrination, a politicization of ethics, and an atrophy of competence' (Stansbury & Barry, 2007). Ethics programs that are value-based inspire employees to follow and practice it; compliance-based programs, however, discourage them to use their moral judgment. Here it is interesting to observe that both views are congruent in the perspective that business ethics seeks to improve human conditions (Michalos, 1988) and any dissension is most likely related to the way it is handled. Ulrich (1997), in this regard, recommends that business ethics must be seen as fundamental reflections for management and if this fundamental aspect is confused with 'given' conditions it would lead to halting the ethical reflection and, ultimately, to 'ethical suicide' (based on the translation given by Beschorner, 2006). This is the *basic* consideration of our research, that is, to shed further thoughts on the positive impact of ethics training.

Inspired by positive correlation between organization's core values, ethical perspectives, and profitability, there have been arguments for the implementation of ethics codes which, it is argued, helps in ethical dilemmas in business involving greater complexity and unique situations (Arlow & Ulrich, 1980), enhances ethicality in culture (Ferrell & Gresham, 1985), provides behavioral norms and values to organizations (Hunt, Wood, & Chonko, 1989), offers roadmap for individual conduct at work, and has positive impact on individuals' attitude and behavior (Hunt et al., 1989). However, merely creating ethics codes does not guarantee that employees would be aware of their contents (Stevens, 1994). Their main purpose should be to educate employees about their purposes (Benson, 1989), which can best be done by communicating them to employees (Baum & Kling, 2004). The importance of communicating ethical codes, in the process imparting ethics training, has been advocated in this regard (e.g., Benson, 1989; Murphy, 1995; Weaver, 1993). Ethics training gives a clearer stand of organizations' position on various ethical situations (Schwartz, 2001) and helps to avoid legal problems (Ferrell, John, & Linda, 2011). Scholars also see this as an alternative to 'inspired ethical environment' in organization, because it is easy to control the employees' actions through ethics training (Valentine, 2009).

Given the importance and potential impact of training on organizations, and the costs associated with the development and implementation of training, it is important that both researchers and practitioners have a better understanding of the relationship between design and evaluation features and the effectiveness of training and development activities. Scholars, on several occasions, have advocated the same. Shandler (1996) calls for reengineering the training function. Spender (1994) urges for more dynamic epistemology for business ethics education for its proper implementation. Ellis (1965) proposes that maximizing training outcomes need the use of variety of training styles and stimuli. Here it is pertinent to mention that learning is not bounded by the type of methodology or tool used; it can take place in varied settings, whether formal, non-formal, or informal. More specifically, ethical knowledge is necessary for ethical reasoning, experiential ethical knowledge is necessary for moral sentiments, and practical ethical knowledge delivers ethical praxis (Park 1998). Appraising the same, organizations are not only following traditional methods of training but also imbibing new initiatives in ethics training; distribution of ethics newsletter, pamphlets, posters, online assistance, role play, videos, workshops, and so on are done to increase employees' attention toward business ethics instead of using traditional pedagogy.

It has been posited that informal ethics training in the form of moral discourse is 'good conversation' (Waters, 1988), which caters to the three categories of its use namely, problem solving and other functional and nonfunctional usages of moral discourse (Bird, Westley, & Waters, 1989). Learning is further activated with informal training as it makes an employee to 'feel' it (Barber, 2004), which usually is absent in formal training. Informal training helps in development of tactic skills that are useful for effective performance; Frazis, Gittleman, and Joyce (1998) posit that employees find it easier to recall the contents of informal training and it is an important way to acquire job-related skills. Informal training does not mean unintentional acts but it involves the indirect control of the management; it is rather an impromptu way of learning at minimum cost. Employees do not sense the pressure of (formal) learning. Additionally, informal training is a step toward building the community of practice or CoP (Lave & Wenger, 1991) as it facilitates the development of groups where members interested in 'ethics' *do* share information and experience, learn from each other, and that helps them to accomplish their personal and professional goals. This helps in elevating an organization's performance in the social capital dimension.

The above aspects were reinforced while doing primary investigation about ethics training in Indian IT companies; a project manager in a company informed during our telephonic discussion that their ethics training consists of variety. We asked her to send a mail, which was as follows (the company's name is changed to X):

> We have both formal as well as informal ethics training:
>
> 1. Posters all around mentioning how X considers it seriously.
> 2. Forced screen savers in computers emphasizing ethics. They also display at times details of frauds that have been identified in the past and their consequences.
> 3. X has always given a clear message that if anytime any unethical thing is reported to have been committed by an employee, s/he would be terminated at the same very moment.
> 4. We attend a 30 minutes online session once in a year where we are shown some scenarios of corporate world and what should be the right response from our end in those situations.

Considering the above discussion, we predict the following: (a) ethics training has a positive impact on the perception of importance of ethics, individual ideology, and organizational ethical values; (b) the perception of importance of ethics is an antecedent of individual ideology as well as organizational ethical values. They have been considered in the theoretical model—Perception of Ethics Training in Employees and Organization (PETINEO). We also predicted that the impact of first and second predictions will have varied impact on ethics training, depending on the category of training used—formal, informal, or both. We describe below the theoretical basis for our predictors. We also discuss the details of our empirical study, the importance of doing contextual research, and the reason for choosing the Indian IT sector.

Literature Review

We review the literature related to different aspects of the PETINEO model (see Fig. 17.1).

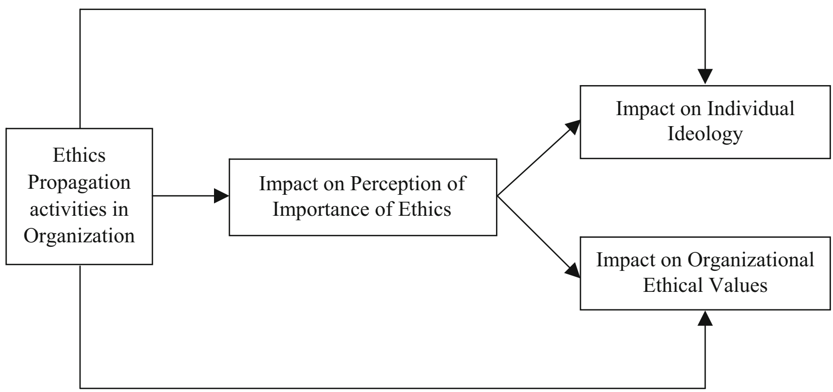


Fig. 17.1 The PETINEO (Perception of ethics training in employees and organizations) model

Ethics Training and Perception of Importance of Ethics

Perception is the first step toward knowledge, that is, it is the first faculty of the mind which drives us toward a reflection. Whether it is an internal or external image of the organization, both are outcomes of perceptions of individuals. Training is one of the many ways that organizations use to strategize a 'positive perception/image' among employees. Ethics training gives a clear idea about how an organization emphasizes upon ethics. Employees of organizations that have formalized ethics training have more positive perception about their companies' ethical context than the employees of organizations that do not (Valentine & Fleischman, 2004). Its prevalence in an organization gives clear indications of its seriousness and the expected organizational citizenship behavior. Time and again it has been found out that professionals' ethical behavior depends on their perception of organizational values and managerial ethics (Hunt & Vitell, 1986; Vitell & Festervand, 1987; Ferrell & Skinner, 1988; Vitell & Davis, 1990a; Jin, 1997). Hence, we suggest that ethics training strongly correlates with the perception of importance of ethics, which can be maximized with the use of combination of formal and informal training.

Hypothesis 1 Combined use of formal and informal ethics training leads to increased perception of the importance of ethics.

Adams, Taschian, and Shore (2001) urge to make efforts to facilitate the permeation of organizations' ethical culture throughout to clarify the expected code of behavior. Since training can enhance employees' awareness of their organizational values (Ponemon, 1996; Sims, 1991; Valentine & Fleischman, 2004), it helps them to understand the common ethical problems experienced in the workplace (Loe & Weeks, 2000; Palmer & Zakhem, 2001), enhances employees' ethicality and perception of work performance (Murphy, 1995; Trevino & Nelson, 1999), and acts like a psychological contract with the organization (Rousseau, 2004); hence it may be interpreted that effective training increases the importance of ethics and also permeates in an organization's culture.

Impact of Ethics Training on Individual Ideologies

Stevens (1984), studying both business executives and students, finds that executives scored higher in the area of personal ethics. Hollon and Ulrich (1979), comparing personal business ethics of students and executives, notice that students had lower standards than their executive counterparts. In this regard, Fritzche and Becker (1982) reason that since students possess no rules or guidance for dealing with ethical problems, they use personal discretion to deal with situations involving ethics. This body of knowledge indicates the importance of ethics training to executives that can serve as guidelines in performing their day-to-day activities. The fact was reinforced by White and Montgomery (1980) who find that while many companies have adopted codes of ethics, managers do not inform all organization employees of the ethics guidelines, which may also be a reason of unethical behavior by employees. Hence, Valentine and Barnett (2002, pp. 197–198) argue that 'when employees believe that the organizations for which they work have strong ethical values, they appear to be more likely to engage in ethical behavior'.

Individuals' characteristics impact ethical behavior (Trevino, 1986) and their cognitive moral development is a continual process that occurs throughout their life span (Kohlberg, 1969; Murphy, Laczniak, Bowie, & Klein, 2005). The impact of an implemented ethics code is related to the development of employee traits and attitudes that are instrumental to advancement in corporate ethical context (Valentine & Johnson, 2005). External factors such as the promise of reward or the threat of punishment embedded in organizational rules, policies, and procedures can influence individuals to comply with moral standards, which may not necessarily become motivators unless individuals integrate them into their personal belief systems (Vidaver-Cohen, 1998); here the role of ethics training becomes more crucial as it can increase the moral resistance and inspire individual to inherit ethics. As per the theory of planned behavior, behavioral intentions are in part based on individuals' opinions about specific conduct (Ajzen, 1991); hence the positive perception of ethics training will have impact on individuals' behavior.

Presence of codes of conduct and their positive perception influence people's immediate attitudes about employment in a company (e.g., Hunt et al., 1989; Trevino, Butterfield, & McCabe, 1998; Valentine, Godkin, & Lucero, 2002; Vitell & Davis, 1990a), and help to improve individual ethical evaluations and work behavior (Adams et al., 2001; McCabe, Trevino, & Butterfield, 1996; Schwartz, 2001; Singhapakdi & Vitell, 1991). However, there is no extensive research to find how the discussion of ethics codes is associated with individual ethics (Valentine & Johnson, 2005), which is another motivation for this research, that is, to find the impact of ethics training on individual ideologies. It is axiomatic that unless individuals imbibe the wisdom, it is difficult to practice the same. Since an individual's conviction has more emotional force (Folger, Cropanzano, & Goldman, 2005), it becomes significant to explore the relationship between ethics training and its impact on individual ideologies. After all, it ultimately relies on individual, rather than institutional processes, to produce better ethics (Sinclair, 1993). External forces will not be effective unless individuals are inspired from within. Considering the above arguments, we suggest that ethics training impacts individual ideologies but varies with the category of training used. Perception of importance of ethics also impacts individual ideologies.

Hypothesis 2 Combined use of formal and informal ethics training has more impact on individual ideologies as compared to the other forms of training.

Hypothesis 3 Higher perception of importance of ethics impacts individual ideologies positively.

Impact of Ethics Training on Organizational Ethical Values

It is observed that the ethical organizational culture takes shape with respect to organizational norms, subsequently rules are formulated, imparted, and practiced; training plays a major role in the execution of this process. Literature is awash in this regard. Ethics education enhances ethical organizational culture (Ferrell & Gresham, 1985; Hunt & Vitell, 1986; Trevino, 1986; Wotruba, 1990; Brass et al., 1998; Trevino & Nelson, 1999), provides organizational behavioral norms and values (Hunt et al., 1989; Sims, 1991; Trevino et al., 1998; Valentine & Barnett, 2002), gives clear direction as regards organizational position on various ethical situations (Schwartz, 2001), and also helps to avoid legal problems (Ferrell et al., 2011). Presence of ethical norms also motivates individuals to retaliate more strongly if an action violates a norm (Gloria & Ridder, 1977).

Furthermore, according to Benjamin (2008), employers may face various lawsuits arising out of discrimination, wrongful termination, and sexual harassment; they are less likely to face them if employees and managers know their rights and responsibilities that are facilitated by training. Schwartz (2001) cites ignorance as one of the reasons for noncompliance of ethical codes; educating employees about ethics is the solution of the above problem. 'Institutionalizing ethics' (Weber, 1993) is important and can be done through training. LeClair and Ferrell (2000) suggested that ethics educational programs profoundly shape company's culture. Effective training and education efforts are often focused on helping employees understand ethical standards and their workplace applications (Leclair, Ferrell & Ferrell, 1997). It instills organizational values, beliefs, rules, and regulations in employees, and helps them to draw lines between acceptable and unacceptable behavior. The impact of training can be made more effective by innovative business ethics training methods (LeClair & Ferrell, 2000). Therefore, we suggest that ethics training impacts organizational ethical values and varies with the training type that is used. Perception of importance of ethics also impacts organizational ethical values positively.

Hypothesis 4 Combined use of formal and informal ethics training has more impact on organizational ethical values as compared to the other forms of training.

Hypothesis 5 Higher perception of importance of ethics impacts organizational ethical values positively.

Contextual Research Gives Focused Results

We have tested the hypotheses in the context of the Indian IT sector. Indian businesses are no more local, they are operating globally. Hence they need a brand image that can be trusted and valued, which is possible only through ethical business practices. But practicing ethics is a complex process as it espouses factors like society's cultural norms, company's culture, and employees' personal virtues; so it becomes more important to find the impact of ethics training in specific context.

Pfeffer (1998) posits that a particular industry conveys more meaningful results than cross-industry studies because social and economic conditions are constant for all firms in the same industry. Moreover, not enough research has been done on issues related to human resources (HR) in the Indian perspective (Budhwar & Sparrow, 2002). Ethics training being pertinent to HR, this research is an attempt to fill this gap. Additionally, India is the first nation in the Asia-Pacific region to create a ministry of Human Resource Development (Rao, 2004) and Indian IT sector is an interesting context to zero in on (Majumdar, 2010). They are relevant to study ethics training from an Indian perspective.

Furthermore, we study the Indian IT sector because of its less representation in various researches done in the area of ethics training; research is mostly done for marketing employees, except in few cases where the sample is from the IT industry (Jin & Drozdenko, 2010; Jin, Drozdenko, & Bassett, 2007). Ethics training is also crucial in the Indian IT sector especially when there are two bodies of knowledge, one which believes that MIS professionals have many opportunities in their firm to behave unethically (Vitell & Davis, 1990b) and the other (Chonko & Hunt, 1985) which believes that MIS professionals believe that their companies tend to have higher ethical standards as compared to other firms. Considering the enormous size of the Indian IT sector, expected growth, and criticality to India's growth, it becomes essential to understand the impact of ethics training.

Research Method

Huselid, Jackson, and Schuler (1997) argue that HRM research has to take into account the effective practices than documented policies; hence we test the validity of the PETINEO model empirically. Descriptive research-survey method was adopted, aimed at systematically identifying and recording a certain phenomenon, process, collection, or system; the main goal is to analyze a population restricted by time and to a particular area.

We collected data online for its ease to reach the target sample which was Internet savvy (Wright, 2005). It also took less time to reach people with common characteristics in a short time span, despite being separated by geographic distances. Google doc was used for the survey. Database of engineering and management students who were placed through campus selection was collected from placement offices of colleges from Bangalore and the NCR region. 1054 students who were placed in IT Companies were selected from the list. A request mail was sent to them which included the URL link to the questionnaire with the assurance that their information would be kept confidential. Eleven e-mails bounced back, 56 people reported that they did not work with IT companies anymore; we received 276 responses, 10 were partially filled and hence discarded. Thus, the response rate was 32.54 percent. Finally, we analyzed 266 responses, completed in all the aspects. The sample had nearly 67.23 percent of companies from Bangalore and 32.76 percent from NCR region, which is an adequate representation of the population. Out of 266 respondents, 18.42 percent did not have any training in ethics, 9.02 percent had informal training, 42.85 percent had formal training, and 29.69 percent had both formal and informal training.

The instrument consists of 50 questions that include information about demographics, ethics training modes, perceived role of ethics, individual ethical ideologies, and corporate ethical values (see Appendix 1). Eleven questions were used for analyzing demographics; 8 for training modes; 10 questions were taken from the perceived role of ethics and social responsibility (PRESOR) scale (Singhapakdi, Vitell, Rallapalli, & Kraft, 1996), for the perceived role of ethics (6 of the PRESCOR scale questions were left either because their factor loading was too low or they were related to social responsibility that was not under the purview of this research); 5 questions for corporate ethical values (Hunt et al., 1989); and 20 for individual ethical ideologies (Forsyth, 1980). An open-ended question was added to explore deviant responses to the close-ended questions, which also allowed the respondents to express themselves without being influenced by the researcher.

To avoid confusion between formal and informal training, we clearly categorized them. Formal training was defined in the survey as training that was planned in advance, had a structured format, defined curriculum, directly governed, held in a classroom-like ambience (workshop, conference, and/or seminar), leading to formal qualification, certification, or attendance. Informal training was considered as unstructured, indirectly governed, involving little or no reliance on predetermined guidelines, easily relatable to situations and individuals, instilling self-learning, and was self-paced like role play, imparted through pamphlets, posters, forced screen savers, counseling, and mentoring.

Reliability and Validity

The reliability of the scales was the following: PRESCOR scale $\alpha = 0.712$, corporate ethical values $\alpha = 0.687$, individual ideologies $\alpha = 0.914$; α value for corporate ethical value is a little less than 0.7 which is acceptable since questions were less and it was a survey (Field, 2009, p. 668). Consistency of all 35 questions (combining all three scales) was tested and the overall $\alpha = 0.890$. As the hypotheses are based on previous research, the scales have been used in many studies (e.g., Jin et al., 2007; Valentine & Fleischman, 2004; Singhapakdi et al., 1996), and the α value is robust; hence the scale is stable and valid (Shadish, Cook, & Campbell, 2002).

Findings

Hypothesis 1 Combined use of formal and informal ethics training leads to increased perception of importance of ethics.

The mean score of perception of role of ethics (5.027) in the companies which had a combination of formal and informal (CFI) training is higher than that of companies having no training on ethics (NN) (4.096). This score is also higher as compared to companies which had either informal (IO) (4.425) or only formal training (FO) (4.417) (see Table 17.1, Part 1). Since F (3262) = 16.116 and is significant at 1 percent, its coefficient

Table 17.1 Multiple regression with 'combination of formal and informal' training as dummy variable

Independent variables	β	T value	Sig. of T
Part 1. Dependent variable—'perception of important of ethics'			
No training	−0.421	−6.452	0.000
Only informal training	−0.201	−3.254	0.001
Only formal training	−0.352	−5.253	0.000
F (3262) = 16.116 Sig. of F = .000 R^2 = 0.156			
Part 2. Dependent variable—'organization's ethical value'			
No training	−0.377	−5.952	0.000
Only informal training	−0.368	−6.138	0.000
Only formal training	−0.438	−6.731	0.000
F (3262) = 22.428 Sig. of F = .000 R^2 = 0.204			
Part 3. Dependent variable—'individual ideologies'			
No training	−0.332	−5.118	0.000
Only informal training	−0.143	−2.331	0.020
Only formal training	0.104	1.562	0.119
F (3, 262) = 17.168 Sig. of F = .000 R^2 = 0.164			

is also statistically significant since $p \leq 0.01$. In comparison to the coefficient of companies having CFI training, the mean values of the perception of role of ethics of company having FO, IO, and NN are lesser by 0.931, 0.602, and 0.610, respectively. All values are statistically significant at 1 percent. This indicates that the combined effect of formal and informal ethical training has greater impact on the perception of role of ethics on employees than does only formal or informal or no training. This also validates that use of multiple tools in training helps employees to register and learn organizational perspectives toward ethics.

Hypothesis 2 Combined use of formal and informal ethics training has more impact on individual ideologies as compared to the other forms of training.

The mean scores of individual ideologies of the employees in the companies which had FO (4.463), IO (4.148), and NN (3.762) are less than companies practicing CFI (4.691). Again it was tested by regressing the mean score of individual ideologies on the category of training conducted at the companies and statistically (see Table 17.1, Part 3). This verifies the deeper impact on individual ideologies by use of CFI at 5 percent significance level. Here it is interesting to note that the difference between mean of individual ideologies of employees in companies having FO and CFI was lesser as compared to IO, which indicates that the employees perceive ethics as a serious issue and formal ethics training has better impact on them.

Hypothesis 3 Higher perception of importance of ethics impacts individual ideologies positively.

Table 17.2, Part 2 demonstrates that the regression coefficient of mean score of perception of role of ethics is 0.541 and statistically significant since $p < 0.01$. It indicates that the marginal rate of change in mean score of individual ideologies was 0.541 for every one scale increase in the mean score of perception of role ethics and it was statistically significant also.

Hypothesis 4 Combined use of formal and informal ethics training has more impact on organizational ethical values as compared to the other forms of training.

The mean score of organizational ethical values (4.003) in companies which conduct CFI is higher than that of companies with NN (3.602), IO (2.759), and FO (3.146). It was tested by regressing the mean score of organizational ethical values on different categories of ethics training conducted in companies. In Table 17.1, Part 2, different categories of training, that is, no training, only formal, only informal, and both informal and formal have varied impact and is verified since F (3262) =

Table 17.2 Regression analysis

	Independent variable = 'Perception of importance of role of ethics'	β	t value	p value
Part 1.	Dependent variable = 'Organization's ethical value' $F(1264) = 4.643$ $R^2 = 0.017$	0.131	2.155.032	
Part 2.	Dependent variable = 'Individual ideologies' $F(1264) = 59.043$ $R^2 = 0.183$	0.428	7.684	.000

22.428, significant at 1 percent; its coefficient was also statistically significant since $p < 0.01$. Comparing with mean value of base variable CFI, the mean value of the organizational ethical values of companies which conducts NN is lesser by 0.941, IO is lesser by 1.244, and FO training is lesser by 0.857, all statistically significant at 1 percent.

From this analysis it is inferred that CFI creates greater impact on the mean value of organizational ethical values of companies than others having FO, IO, and NN. It is interesting to note that mean score of organizational ethical values having IO is less than the other three categories. They imply that (a) only IO may give perception of 'non-seriousness' of ethical issues in organizations, (b) only IO fails to give standard format of 'right and wrong' and in such cases employees mainly depend on individual's choice, and (c) only IO decreases the sensitivity toward consequences of negative action.

Hypothesis 5 Higher perception of importance of ethics impacts organizational ethical values positively.

The regression coefficient of mean score of perception of role of ethics is 0.148 and statistically significant since $p < 0.01$. This indicates that the marginal rate of change in mean score of organizational ethical value is 0.148 for one every one scale increase in the mean score of perception of role ethics; thus, the impact of mean score of perceptions of role of ethics on mean score of organizational ethical value is positive and also significant (see Table 17.2, Part 1).

Comparing the values of impact of perception on individual ideologies and organizational ethical values, it was a matter of concern to observe that impact is more on individual ideologies. It also is statistically confirmed because the impact of individual ideologies is insignificant on organizational ethical values ($R = 0.12$, $F = 0.041$, df 1/264, $p = 0.840$, which is greater than 0.01). This fact is an addition to the present knowledge that ethical culture of an organization is not the outcome of an individual's choice, but a combined effort of management and employee. It also implies that employees' individual ideologies may not get converted to organizations' ethical culture unless there is a conducive environment for its demonstration.

Analysis of Open-Ended Question

The open-ended question is: Discuss in brief the benefits of the ethics training (formal as well as informal) at professional as well as at personal level. It was an optional question. Out of the 201 responses we received, 44 responses were invalid with answers like, 'Why you are doing this research', 'Questionnaire was big', 'Why do you want my name', 'N/A', 'Questionnaire was framed nicely', and so on; only 157 respondents gave valid response. Next, we analyze them.

One hundred and thirty-four respondents have undergone the experience of ethics training. They supported ethics training for reasons like information about company's expectations provides clear demarcation between the do's and don'ts, helpful to operate in diversified culture of MNCs, portrays commitment from CEO's and top management, and so on. There was not a single complaint about the 'control' aspect of ethics training, but the majority expressed that until and unless the top management becomes the part of it and adheres to its guidelines, the impact cannot be realized.

The respondents have advocated that ethics training has helped them in situations of moral ambiguity where they could refer to coded rules and customs. This outcome can be interpreted in the following manner. One, employees get help from the codes in difficult situation. Two, ethics codes may be employed as escape routes by employees, rather than taking responsibility for their own choices and actions; hence employees may use them for their comfort and not for betterment of the organizational ethical health.

Respondents also expressed the boredom caused due to lengthy formal trainings. Out of 157 valid responses, 13 have not fully supported ethics training. They expressed that ethics cannot be taught and may only help to discuss the complex ethical issues that impact them and organizations. One response was crucial as it contained nearly all the negative aspects of ethics training expressed by 13 respondents. It is the following:

> Ethics training is a waste of time and organization[al] money. Nothing good can come from boring an employee to death. … [E]thics usually come … from society, a mere training programme that … [is] highlighted in power point slides does not really help anyone.[1]

[1] These are views expressed by respondents in the open-ended question. It was an optional question.

The above views pull our attention to three issues. First, ethics training involves lot of money; hence, if not handled with utmost care, it creates negative impact on employees. Employees perceive it to be wasting their time and organization's money. Second, training or lectures on ethics will not make a person more ethical if he or she does not have these core values to begin with. Third, boredom may be an outcome of formal training. These views of the respondents are additional learning from this research, which, if combined with the other outcomes mentioned below, can enable better understanding of different perspectives of ethics training.

Discussion

The above findings indicate that ethics training can lead to better impact through the combination of formal and informal trainings. It positively influences the perception of importance of ethics, individual ideologies, and organizational ethical values. Perception of importance of ethics is correlated to individual ideologies and organizational ethical values. Practicing only informal ethics training sometimes may clearly show an organization's emphasis on ethics; hence, employees should be trained through formal programs. Formal training is better in conveying the information in more precise ways as it is more of 'compliance-oriented' style (Stansbury & Barry, 2007). Perception of importance of ethics has greater impact on individual ideologies as compared to organizational ethical values, which implies that employees use their ideologies if they understand the importance of ethics, but it does not directly convert into organizational activities. This result calls for the importance of the role of the management and superiors in implementing ethical values. Moreover, they themselves need to exhibit ethical business conduct and ensure its proper implementation in two ways namely, leading by example and providing employees with necessary inputs and infrastructure (like ethical organizational culture). Importantly, institutional support is a must for the effectiveness of ethics training programs.

The question was, 'Discuss in brief the benefits of the ethics training (formal as well as informal) at professional as well as at personal level'. The answers are provided as 'insights from respondent', it helped us to know facts from the 'horse's mouth'.

Furthermore, we have noticed that hardly anyone wants to be associated with unethical companies. They may not represent the population in its totality, but it is not a surprising finding considering that majority of employees want hassle-free, peaceful, growth-oriented, employee-friendly, and reputed organizations hallmarked by ethical functioning. Out of 266 respondents, nearly 82 percent of them have reported to have undergone some form of ethics training, which gives clear indications of the prevalence of ethics training in various IT companies in India.

Limitations and Future Scopes of Research

There are some limitations of this study which we enumerate here. The sample is collected only from a specific database and the response rate was only 32.54 percent; hence there may be generalizability problem. Research on a bigger sample may be the best way to tackle the problem of generalization. This limitation would not have much impact as all samples belonged to the same population. There are various aspects which must be looked into before generalizing the outcome of the research. First, individual ideologies and ethical culture are not built easily, say, by imparting a few training programs but it may be the outcome of well-articulated recruitment policies, that is, companies should make sure that they select the right candidates during hiring. At the same time it cannot be discarded that some notable endeavors like ethical training can change employees' views about ethics and hence it should be imparted diligently.

Second, some people, having high self-esteem and favorable self-image, are careful about their actions (Brockner et al., 2003). This may be the main reason behind their sensitivity toward (ethical) decision making. This limitation can be somewhat taken care of by the following argument. That is, if ethics training is given to these people, they will become more conscious toward their actions. If analysis of individual ideologies is done at the time of hiring and compared after they undergo the ethics training, it can give a better understanding about them.

Thirdly, the popular notion that organizational culture (OC) is usually deeply rooted and encourages employees to behave as per an organization's expected norms and values, is not necessarily true if we consider individual ideologies (Jackall, 1988). However, OC is the outcome of an organization's HR practices like recruitment, training, norms, and rules. A study of organization's HR policies in addition to this research can ensure holistic knowledge about the impact of ethics training.

Fourthly, this research does not cover the negative impacts of ethics training like creating control, increased sensitivity, hesitancy in decision making, politicization of ethics, and so on. It may be countered by considering that almost every training program has negative consequences. And, we cannot disregard the higher order purposes like building ethical organizations that ethics training aims at. Hence, the fear of, say, non-compliance of ethics training is smaller in comparison to bigger problems arising out of unethical practices that may result in its absence. The negative outcomes can be dealt with better organizational processes, involvement of employees, empowered decision making, increased awareness of the benefits of ethics, and so on. Concerted effort by the top management is the best way to deal with these crucial yet complex issues. Studying these issues will add to the existing knowledge of the impact of ethics training.

Conclusion

The business environment is becoming increasingly volatile with continuous pressure to survive and grow, and make profit. Its unwarranted outcomes are unethical and illegal acts to make the profit numbers. But the good news is that organizations have begun realize that if they want to get rid of this 'vicious circle' of making profit and more profit by hook or by crook, they need to take steps to create sustainable results which can be attained through ethical functioning. Moreover, legally binding and ethically sound business is what the society is demanding which is forcing them to be ethical and hence initiate programs like ethics training with an aim to assure long-term profitability and growth.

In this study, we have investigated the modus operandi that the Indian IT companies employ to carry out ethics training. Specifically we have investigated whether formal, informal, or both forms of ethics training programs as leading to ethical sensitization of the workplace. It is known that educating employees through varied tools helps in 'getting the facts registered' in them. Learning through different means makes the experience of training less monotonous and boring, as reported by the respondents. In this regard, the following is the viewpoint of an employee at a senior level, having 19 years' work experience in the Indian IT industry.

> Over the years of my work life, I have realized that formal and informal training are complement to each other. Formal trainings are usually in instructive style and are more structured. Informal training is also advantageous within an organization. This is mainly because this mode of training gives people time to absorb and then think about the subject line. We see posters being put on the walls, occasional announcements being made, related quizzes/debate competitions being arranged and many other creative measures taken to keep the message on top of everyone's mind. In this way of communication, people get engaged and so it works as the supplement way of establishing the intention.[1]

We have found out that the combination of formal and informal ethics training works better because it professionally conveys 'seriousness' of the issue as well as encourages employees for discussion and involvement. Informal training opens up for 'CoP', where employees share their views, inherit advantages of ethical behavior without feeling the pressure of control, and do not get bored. Moreover, this approach instills the importance of ethics in an individualized way. The role of informal ethics training is important because employees usually appreciate consulting, rather than commanding modes of learning. Apparently individual effects of only formal or informal training do not have much impact. Only formal training may create perceptions such as: it is done for the sake of being done, it is meant to control people, its guidelines are only meant for middle and lower level and not for the top management, it mainly serves to comply with government regulations. Although informal ethics training is more employee-centric and friendly, but it may lack the rigor and seriousness that are needed to address issues pertaining to business ethics. Hence, we need a combination of formal and informal ethics training programs in order to build and sustain ethical companies.

* *

Appendix 1

Scales Used

PRESOR scale—Perceived role of ethics and social responsibility (The items related to CSR and those having very less factor loading were removed) *(Singhapakdi et al.,* 1996)

1. Being ethical is the most important thing a firm can do.
2. Corporate planning and goal setting sessions should include discussions of ethics.
3. The most important concern for a firm is making profit, even if it means bending or breaking the rules.
4. The ethics of a firm is essential to its long-term profitability.
5. The overall effectiveness of a business can be determined to a great extent by the degree to which it is ethical.
6. To remain competitive in a global environment, business firms will have to disregard ethics.
7. Ethics and profitability can be compatible.
8. If survival of a business enterprise is at stake, then you must forget about ethics.
9. Efficiency is much more important to a firm than whether or not the firm is seen as ethical.
10. Ethics matters till stakeholders are happy.

Individual ideologies (Forsyth, 1980*).*

1. A person should make certain that their actions never intentionally harm another even to a small degree.
2. Risks to another should never be tolerated, irrespective of how small the risks might be.
3. The existence of potential harm to others is always wrong, irrespective of the benefits to be gained.
4. One should never psychologically or physically harm another person.
5. One should not perform an action which might in any way threaten the dignity and welfare of another individual.

6. If an action could harm an innocent other, then it should not be done.
7. Deciding whether or not to perform an act by balancing the positive consequences of the act against the negative consequences of the act is immoral.
8. The dignity and welfare of people should be the most important concern in any society.
9. It is never necessary to sacrifice the welfare of others.
10. Moral actions are those which closely match ideals of the most 'perfect' action.
11. There are no ethical principles that are so important that they should be a part of any code of ethics.
12. What is ethical varies from one situation and society to another.
13. Moral standards should be seen as being individualistic; what one person considers to be moral may be judged to be immoral by another person.
14. Different types of moralities cannot be compared as to 'rightness'.
15. Questions of what is ethical for everyone can never be resolved since what is moral or immoral is up to the individual.
16. Moral standards are simply personal rules which indicate how a person should behave, and are not to be applied in making judgments of others.
17. Ethical considerations in interpersonal relations are so complex that individuals should be allowed to formulate their own individual codes.
18. Rigidly codifying an ethical position that prevents certain types of actions could stand in the way of better human relations and adjustment.
19. No rule concerning lying can be formulated; whether a lie is permissible or not permissible totally depends upon the situation.
20. Whether a lie is judged to be moral or immoral depends upon the circumstances surrounding the action.

Corporate ethical values (Hunt et al., 1989)

1. Managers in my company often engage in behaviors that I consider to be unethical. (R)
2. In order to succeed in my company, it is often necessary to compromise one's ethics. (R)
3. Top management in my company has made it known in no uncertain terms that unethical behaviors will not be tolerated.
4. If a manager in my company is discovered to have engaged in unethical behavior that results primarily in personal gain (rather than corporate gain), he or she will be promptly reprimanded.
5. If a manager in my company is discovered to have engaged in unethical behavior that results primarily in corporate gain (rather than personal gain), he or she will be promptly reprimanded.

References

Adams, J. S., Taschian, A., & Shore, T. H. (2001). Codes of ethics as signals for behavior. *Journal of Business Ethics, 29*(3), 199–211.

Ajzen, I. (1991). The theory of planned behavior. *Organizational Behavior and Human Decision Processes, 50*(2), 179–211.

Arlow, R., & Ulrich, T. A. (1980). Auditing your organization's ethics. *Internal Auditor, 39*(4), 26–31.

Barber, J. (2004). Skill upgrading within informal training: Lessons from the Indian auto mechanic. *International Journal of Training and Development, 8*(2), 128–139.

Baum, H., & Kling, T. (2004). *The transparent leader: How to build a great company through straight talk, openness and accountability*. New York: Harper Business.

Benjamin, M. (2008). Businesses benefit from training. www.hr.blr.com.

Benson, G. C. S. (1989). Codes of ethics. *Journal of Business Ethics, 8*(5), 305–319.

Bernard, W. J., & Montgomery, R. B. (1980). Corporate codes of conduct. *California Management Review, 23*(2), 80–87.

Beschorner, T. (2006). Ethical theory and business practices: The case of discourse ethics. *Journal of Business Ethics, 66*(1), 127–139.

Bird, F., Westley, F., & Waters, A. J. (1989). The uses of moral talk: Why do managers talk ethics. *Journal of Business Ethics, 8*(1), 75–89.

Brass, D. J., Butterfield, K. D., & Skaggs, B. C. (1998). Relationships and unethical behavior: A social network perspective. *The Academy of Management Review*, *23*, 14–31.

Brockner, J., Heuer, L., Magner, N., Folger, R., Umphress, E., Bos, K. V. D., et al. (2003). High procedural fairness heightens the effect of outcome favorability on self-evaluations: An attributional analysis. *Organizational Behavior and Human Decision Processes, 91*(1), 51–68.

Budhwar, P. S., & Sparrow, P. R. (2002). An integrative framework for understanding cross-national human resource management practices. *Human Resource Management Review, 12*(3), 377–403.

Charles, H. J., & Ulrich, T. A. (1979). Personal business ethics: Managers vs. managers-to-be. *Southern Business Review, 5*, 17–22.

Chonko, L. B., & Hunt, S. D. (1985). Ethics and marketing management: An empirical examination. *Journal of Business Research, 13*(4), 339–359.

Ellis, H. C. (1965). *The transfer of training*. New York: McMillan.

Ferrell, O. C., & Gresham, L. G. (1985). A contingency framework for understanding ethical decision making in marketing. *Journal of Marketing, 49*(3), 87–96.

Ferrell, O. C., John, F., & Linda, F. (2011). *Business ethics: Ethical decision making* (9th ed., p. 220). Andover: South-western Cengage Learning.

Ferrell, O. C., & Skinner, S. J. (1988). Ethical behavior and bureaucratic structure in marketing research organizations. *Journal of Marketing Research, 25*(1), 103–109.

Field, A. (2009). *Discovering statistics using SPSS* (3rd ed.). London: Sage.

Folger, R., Cropanzano, R., & Goldman, B. (2005). Justice, accountability, and moral sentiment: The deontic response to "foul play" at work. In J. Greenberg & J. Colquitt (Eds.), *Handbook of organizational justice* (pp. 215–245). Mahwah, NJ: Lawrence Erlbaum.

Forsyth, D. R. (1980). A taxonomy of ethical ideologies. *Journal of Personality and Social Psychology, 39*(1), 175–184.

Frazis, H., Gittleman, M., & Joyce, M. (1998). Determinants of training: An analysis using both employer and employee characteristics. In Key Bridge Marriott Hotel, Arlington VA, US Department of Commerce, Washington, DC.

Fritzsche, D. J., & Becker, H. (1982). Business ethics of future marketing managers. *Journal of Marketing Education, 4*(2), 2–7.

Ghaye, T., & Gunnarsson, E. (2009). Creating cultures of appreciation: Organisational innovation through employee well-being. In D. Marianne & W. Lena (Eds.), *Organising work for innovation and growth. Experiences and efforts in ten companies*. Stockholm: VINNOVA.

Gildin, H. (1983). *Rousseau's social contract: The design of the argument*. Chicago: University of Chicago Press.

Gloria, J. D., & Ridder, R. D. (1977). Aggression in dyadic interaction. *European Journal of Social Psychology, 7*(2), 189–219.

Hollon, C. J., & Ulrich, T. A. (1979). Personal business ethics: Managers vs managers-to-be. *Southern Business Review*, *5*, 17–22.

Hunt, S. D., & Vitell, S. (1986). A general theory of marketing ethics. *Journal of Macromarketing, 6*(1), 5–16.

Hunt, S. D., Wood, V. R., & Chonko, L. B. (1989). Corporate ethical values and organizational commitment in marketing. *Journal of Marketing, 53*(3), 79–90.

Huselid, M. A., Jackson, S. E., & Schuler, R. S. (1997). Technical and strategic human resources management effectiveness as determinants of firm performance. *Academy of Management Journal, 40*(1), 171–188.

Jackall, R. (1988). *Moral mazes: The world of corporate managers*. Oxford: Oxford University Press.

Jin, K. G. (1997). A conceptual framework and research strategy considerations in the study of MIS professional ideology (MPI). In J. M. Carey (Ed.), *Human factors in information systems: Relationship between user interface design and human performance* (pp. 137–156). Norwood: Ablex Publishing Corporation.

Jin, K. G., & Drozdenko, R. G. (2010). Relationship among perceived organizational core values, corporate social responsibility, ethics, and organizational performance outcomes: An empirical study of information technology professionals. *Journal of Business Ethics, 92*(3), 341–359.

Jin, K. G., Drozdenko, R., & Bassett, R. (2007). Information technology professionals' perceived organizational values and management ethics: An empirical study. *Journal of Business Ethics, 71*(2), 149–159.

Kohlberg, L. (1969). Stage and sequence: The cognitive- developmental approach to socialization. In D. A. Goslin (Ed.), *Handbook of socialization theory and research* (pp. 347–480). Chicago: Rand McNally.

Lave, J., & Wenger, E. (1991). *Situated learning: Legitimate peripheral participation*. Cambridge: Cambridge University Press.

LeClair, D. T., & Ferrell, L. (2000). Innovation in experiential business ethics training. *Journal of Business Ethics, 23*(3), 313–322.

LeClair, D. T., Ferrell, O. C., & Ferrell, L. (1997). Federal sentencing guidelines for organizations: Legal, ethical, and public policy issues for international marketing. *Journal of Public Policy and Marketing*, *16*, 26–37.

Loe, T. W., & Weeks, W. A. (2000). An experimental investigation of efforts to improve sales students' moral reasoning. *Journal of Personal Selling & Sales Management, 20*(4), 243–251.

Majumdar, S. K. (2010). Globalization and relative compensation in India's information technology sector. *Information Technologies and International Development, 6*(1), 21–33.

McCabe, D. L., Trevino, L. K., & Butterfield, K. D. (1996). The influence of collegiate and corporate codes of conduct on ethics-related behavior in the workplace. *Business Ethics Quarterly, 6*(4), 461–476.

Michalos, A. C. (1988). Editorial. *Journal of Business Ethics, 7*(1–2), 1–1.

Murphy, P. E. (1995). Corporate ethics statements: Current status and future prospects. *Journal of Business Ethics, 14*(9), 727–740.

Murphy, P. E., Laczniak, G. R., Bowie, N. E., & Klein, T. A. (2005). *Ethical marketing*. Upper Saddle River, NJ: Pearson Prentice Hall.

Paine, L. S. (1994, March–April). Managing for organizational integrity. *Harvard Business Review*, 106–117

Palmer, D. E., & Zakhem, A. (2001). Bridging the gap between theory and practice: Using the 1991 federal sentencing guidelines as a paradigm for ethics training. *Journal of Business Ethics, 29*(1), 77–84.

Park, Hun-Joon. (1998). Can business ethics be taught?: A new model of business ethics education. *Journal of Business Ethics, 17*(9/10)*, How to make business ethics operational: Creating effective alliances: The 10th annual EBEN conference*, July, pp. 965–977.

Pattan, J. E. (1984). The business of ethics and the ethics of business. *Journal of Business Ethics, 3*(1), 1–20, 33–34.

Pfeffer, J. (1998). *The human equation: Building profits by putting people first*. Boston: Harvard Business School Press.

Ponemon, L. (1996). Key features of an effective ethics training program. *Management Accounting, 78*(4), 66–67.

Rao, T. V. (2004). Human resource development as national policy in India. *Advances in Developing Human Resources, 6*(3), 288–296.

Rousseau, D. M. (2004). Psychological contracts in the workplace: Understanding the ties that motivate. *Academy of Management Executive, 18*(1), 120–127.

Schwartz, M. (2001). The nature of the relationship between corporate codes of ethics and behaviour. *Journal of Business Ethics, 32*(3), 247–262.

Shadish, W. R., Cook, T. D., & Campbell, D. T. (2002). *Experimental and quasi-experimental designs for generalized causal inference*. Boston: Houghton Mifflin.

Shandler, D. (1996). *Reengineering the training function: How to align training with the new corporate agenda*. Delray Beach: St. Lucie Press.

Sims, R. R. (1991). The institutionalization of organizational ethics. *Journal of Business Ethics, 10*(7), 493–506.

Sinclair, A. (1993). Approaches to organization culture and ethics. *Journal of Business Ethics, 12*(1), 63–73.

Singhapakdi, A., & Vitell, S. J. (1991). Analyzing the ethical decision making of sales professionals. *Journal of Personal Selling & Sales Management, 11*(4), 1–12.

Singhapakdi, A., Vitell, S. J., Rallapalli, K. C., & Kraft, K. L. (1996). The perceived role of ethics and social responsibility: A scale development. *Journal of Business Ethics, 15*(11), 1131–1140.

Spender, J. C. (1994). Knowing, managing, and learning: A dynamic managerial epistemology. *Management Learning, 25*(3), 387–412.

Stansbury, J., & Barry, B. (2007). Ethics programs and the paradox of control. *Business Ethics Quarterly, 17*(2), 239–261.

Stevens, B. (1994). An analysis of corporate ethical code studies: Where do we go from here? *Journal of Business Ethics, 13*(1), 63–69.

Stevens, G. E. (1984). Business ethics and social responsibility: The responses of present and future managers. *Akron Business and Economic Review, 15*(Fall), 6–11.

Trevino, K. T. (1986). Ethical decision making in organizations: A person-situation interaction model. *Academy of Management Review, 11*(3), 601–617.

Trevino, L. K., Butterfield, K. D., & McCabe, D. L. (1998). The ethical context in organizations: Influences on employee attitudes and behaviors. *Business Ethics Quarterly, 8*(3), 447–476.

Trevino, L. K., & Nelson, K. A. (1999). *Managing business ethics*. New York: Wiley.

Ulrich, P. (1997). *Integrative Wirtschaftsethik. Grundlagen einer lebensdienlichen O¨ konomie*. Bern\Stuttgart\Wien: Haupt.

Valentine, S. (2009). Ethics training, ethical context, and sales and marketing professionals' satisfaction with supervisors and coworkers. *Journal of Personal Selling & Sales Management, 29*(3), 227–242.

Valentine, S., & Barnett, T. (2002). Ethics codes and sales professionals' perceptions of their organizations' ethical values. *Journal of Business Ethics, 40*(3), 191–200.

Valentine, S., & Fleischman, G. (2004). Ethics training and businesspersons. Perceptions of organizational ethics. *Journal of Business Ethics, 52*(4), 391–400.

Valentine, S., Godkin, L., & Lucero, M. (2002). Ethical context, organizational commitment, and person organization fit. *Journal of Business Ethics, 41*(4), 349–360.

Valentine, S., & Johnson, A. (2005). Code of ethics, orientation programs, and the perceived importance of employee incorruptibility. *Journal of Business Ethics, 61*(1), 45–53.

Vidaver-Cohen, D. (1998). Motivational appeal in normative theories of enterprise. *Business Ethics Quarterly, 8*(3), 385–407.

Vitell, S. J., & Davis, D. L. (1990a). The relationship between ethics and Job satisfaction: An empirical investigation. *Journal of Business Ethics, 9*, 489–494.

Vitell, S. J., & Davis, D. L. (1990b). Ethical beliefs of MIS professionals: The frequency and opportunity for unethical behavior. *Journal of Business Ethics, 9*(1), 63–70.

Vitell, S. J., & Festervand, T. A. (1987). Business ethics: Conflicts, practices, and beliefs of industry executives. *Journal of Business Ethics, 6*(2), 111–122.

Waters, J. A. (1988). Integrity management: Learning and implementing ethical principles in the workplace. In S. Srivastava (Ed.), *Executive integrity*. San Francisco: Jossey-Bass.

Weaver, G. R. (1993). Corporate codes of ethics: Purpose, process and content issues. *Business & Society, 32*(1), 44–58.

Weaver, G. R., Trevino, L. K., & Cochran, P. L. (1999). Corporate ethics programs as control systems: Influences of executive commitment and environmental factors. *Academy of Management Journal, 42*(1), 41–57.

Weber, J. (1993). Institutionalizing ethics into business organizations: A model and research agenda. *Business Ethics Quarterly, 3*(4), 419–436.

White, B. J., & Montgomery, R. B. (1980). Corporate codes of conduct. *California Management Review*, *23*, 690–697.

Wotruba, T. R. (1990). A comprehensive framework for the analysis of ethical behavior, with a focus on sales organizations. *Journal of Personal Selling & Sales Management, 10*(2), 29–42.

Wright, K. B. (2005). Researching internet-based populations: Advantages and disadvantages of online survey research, online questionnaire authoring software packages, and web survey services. *Journal of Computer-Mediated Communication, 10*(3). Retrieved from http://onlinelibrary.wiley.com/doi/10.1111/j.1083-6101.2005.tb00259.x/full.

18

Leadership Excellence in Organizations in the Mekong Region: A Comparative Study of Thailand, Cambodia, Lao, and Vietnam

Christopher Selvarajah and Denny Meyer

Introduction

This research seeks to develop an understanding of work and leadership values as perceived by local managers. Though the extant literature has charted managerial values of countries such as Thailand (e.g., Selvarajah, Meyer, & Donovan, 2013; Yukongdi, 2010; Cuong & Swierczek, 2008) and Vietnam (e.g., Selvarajah, Meyer, Vinen, & Pham, 2010), a distinct paucity of empirical studies is evident in the other two Mekong countries. Studies such as Selvarajah, Meyer, Davuth, and Donovan (2012) and Chandler (1998) provided an initial explanation for the behavior of Cambodians, based on their adherence to *dharmic*[1] philosophies

[1] The Theravada Buddhist philosophies are based on the concept of *dharma*, which emphasizes duties in the pursuit of individual salvation through self-realization. Righteous duties or following a virtuous path removes or lessens the effect of *karma* where actions of past and present lives may

C. Selvarajah (✉) • D. Meyer
Swinburne University of Technology, Melbourne, Australia
e-mail: cselvarajah@swin.edu.au

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_18

and the Theravada Buddhist traditions of authority, individual pursuit of achievement, social interaction, and balance. The Lao People's Democratic Republic, being a land-locked nation and one of the poorest, has been overlooked. In this chapter, we address some of these concerns and look at the Mekong as a region. Of the four Mekong nations, three are Theravada Buddhist, while Vietnam is Confucian. This chapter does not explore the religious influence on managerial behavior (MB), but addresses the contextual nature of MB in the Mekong organizations.

Literature Review

In this chapter, we discuss the contextual nature of leadership and the influence that this has on leadership behaviors in the Mekong nations. In so doing, we discuss leadership studies that have promoted the relationship of context to the phenomenon of leadership behaviors (see e.g., Selvarajah et al., 2012, 2013; Selvarajah, Meyer, & Jeyakumar, 2011; Selvarajah & Meyer, 2008a, 2008b). The second part of the chapter addresses the theory development and hypotheses based on the literature.

Review of Leadership Studies

Leadership is one of the most researched areas in organizational studies (Yukl, 2005) and, though great strides have been accomplished in this field, there is still a lack of understanding of the cultural context within which leadership functions. Earlier researchers, such as Hofstede (1984), Hofstede and Bond (1988), provided broad categorizations of cultural dimensions and research, and the GLOBE project has used these frameworks to develop further the concepts of leadership and organizational effectiveness. Initiated by Robert House (see House, Hanges, Javidan, Dorfman, & Gupta, 2004; Chhokar, Brodbeck, & House, 2007), the GLOBE project has provided insights into the influence of culture on organizational leadership across 62 nations. Criticism has been leveled at these studies, particularly with regard to the measurement tools utilized.

either aid or prevent salvation. Bad *karma* could lead to reincarnation to a lesser being and good karma could lead to breaking the cycle of rebirths or being reborn into a higher order being.

This has led to an intensifying debate around the use of the Hofstede and GLOBE measurement instruments (see, e.g., McSweeney, 2002; McCrae, Terracciano, Realo, & Allik, 2008; Brewer & Venaik, 2010; Taras, Steel, & Kirkman, 2010; Venaik & Brewer, 2010; Tung & Verbeke, 2010; Shi & Wang, 2011; Minkov & Blagoev, 2012).

Vague interpretations of leadership, particularly within a cultural context, have also received much criticism. The concern arises from how culture is clustered. The GLOBE project (see Gupta, Surie, Javidan, & Chhokar, 2002) derived a ten-cluster cultural grouping. Five cultural clusters are identified within Europe, making up 13 % of the world's population, while the remaining five clusters cover the rest of the world. This disproportionate emphasis of cultural groupings, in terms of the number of countries or the size of populations within the global regions, calls for more detailed examination of the "rest of the world." Furthermore, the fact that the studies are country-based causes further biases. For example, Kennedy (2002), while reporting on the GLOBE study in Malaysia, interpreted the values of a single ethnic group (Malays) as the values for all Malaysian managers, thus ignoring the roles and contributions to leadership of the Malaysian Chinese and the Malaysian Indians in the country.

Therefore, refining the cultural context within which leadership excellence operates, recognizing external influences, and identifying constructs that may influence leadership perceptions within a specific context provide the main thrust of this research. The term "excellence" is used here in its standard definition of surpassing others in accomplishment or achievement (Taormina & Selvarajah, 2005). In this research, excellence in leadership is perceived in terms of the behaviors used by someone in a leadership position, rather than in terms of personal traits or characteristics. This perspective allows both theorists and practitioners to identify behaviors that allow a leader to achieve excellent performance (without excluding the possibility that a leader might possess an excellent character).

Theoretical Framework

In this study, we use the conceptual framework for leadership described in Selvarajah, Duignan, Lane, Nuttman, and Suppiah (1995). This original model was developed for studying managerial leadership in Asia and was based on both western and eastern literature (see Selvarajah et al., 2012 for details). From a group of 94 value statements (see Selvarajah et al., 1995; Taormina & Selvarajah, 2005[2]), a group of researchers from six ASEAN countries (Brunei, Indonesia, Malaysia, Philippines, Singapore, and Thailand) created four broad categories for the study of excellent leaders: personal qualities (PQ), managerial behaviors (MBs), organizational demand (OD), and environmental influences (EIs). The value statements within these categories were then subjected to a Q-sort by Asian managers who were attending executive programs at the Asian Institute of Management in Manila and at the Vocational Technical Institute (VOC-TECH), a Southeast Asian Management Education Organization institute located in Brunei Darussalam. Based on this work, scales for perspectives of an excellent leader (EL) and the four cultural dimensions—OD, PQ, MB, and EI—have been constructed using the statements provided in the Appendix.

"EL" describes the combination of behaviors and attitudes desirable for good leadership within a particular cultural context (Selvarajah & Meyer, 2008b). "PQ" are the individual's values, skills, attitudes, behavior, and qualities; they emphasize morality, religion, interpersonal relationships, and communication. "MBs" cover a person's nature, values, attitudes, actions, and styles when performing managerial duties, emphasizing persuasive powers. "ODs" are the ways in which a manager responds to the goals, objectives, structures, and issues in an organization. They emphasize the importance of organizational prosperity. "EIs" are external factors that affect the success of the entire organization; they emphasize the importance of scanning and evaluating the external environment for opportunities. The four-dimensional framework of Selvarajah et al. (1995) has been applied successfully in numerous studies, in Asia (e.g., Selvarajah et al., 2012, 2013, 2011; Selvarajah, 2008; Taormina & Selvarajah, 2005; Selvarajah & Meyer, 2008a, 2008b), Europe (De Waal, Van der Heijden, Selvarajah, & Meyer, 2012), and Africa (Shrivastava, Selvarajah, Meyer, & Dorasamy, 2014). In each of these studies, cultural factors have been found to be related to the four-dimensional framework,

[2] Both these papers reported on the pilot studies carried out to test the conceptual framework and a pilot sample in five ASEAN countries.

to produce specific cultural context-based models to explain excellence in leadership.

Therefore, the theoretical framing for a study on culture and its influence on leadership requires an understanding of the relationship between the context and the leadership phenomenon being studied (Pawar & Eastman, 1997; Fairhurst, 2009; Linden & Antonakis, 2009). In building the theoretical framework for this study, we have applied the same rationale as Hilton (1998) for building culturally specific models, following Selvarajah et al. (2012), where a nine-factor cultural leadership model was developed and identified as unique to Cambodia and Selvarajah et al. (2013) where an eight-factor cultural leadership model was similarly developed for Thailand. In these studies, the cultural factors were identified through the cultural factor modeling and hypotheses for each of the established constructs.

In this research, based on confirmatory factor analysis and structural equation modeling, the four leadership dimensions and the EL construct provide a unique, nine-factor model to explain leadership behaviors in the Mekong nations. Literature-based support for these dimensions is provided with corresponding hypotheses. The seven hypotheses described below support the notion that the MB constructs influence the two excellence in leadership constructs, in organizations in the Mekong region.

Hypotheses

Managerial Behavior: Organizational Commitment

Organizational commitment and its influence on organizational performance and effectiveness have been studied extensively (see, e.g., Avolio, Zhu, Koh, & Bhatia, 2004; Lok & Crawford, 2004; Loke, 2001). Yousef (2000, p. 514) explained that the "one factor which is believed to affect individuals' attitudes toward change is their commitment to their organizations." It is, therefore, postulated that organizational commitment mediates organizational performance and also that there are change factors that influence organizational commitment in terms of what constitutes an EL in an organization. This suggests that organizational commitment has a mediating relationship to what constitutes an EL and that personal, institutional, and environmental change factors will also influence managers who are committed to their organizations and are more likely to support the concept of leadership excellence in their organizations. Avolio et al. (2004) have demonstrated how psychological empowerment mediates the effects of leadership transformation on nurses' organizational commitment in a large public hospital in Singapore. In another Singapore-based study, leadership behaviors are seen to affect job satisfaction, productivity, and organizational commitment (Loke, 2001). The results suggested that, in order of importance, job satisfaction, organizational commitment, and productivity were influenced by leadership behaviors. What these studies have tried to do is to understand the relationship between leadership behaviors and employee outcomes to "determine if leadership is worth the extra effort" as an organizational commitment that produces performance results (Loke, 2001, p. 191). Based on this understanding, the following hypothesis is forwarded for testing.

Hypothesis 1 Commitment to the organization influences the perception of what constitutes an excellent leader in Mekong organizations.

Managerial Behavior: Effective Decision-Making

Research in leadership and decision-making was popularized by Vroom and Yetton (1973). Vroom (2000, p. 83) argued that "theories of decision making intersect with theories of leadership" and quoted Tannenbaum and Schmidt (1973), who defined styles of leadership as being influenced by "area of freedom afforded subordinates" (cited in Vroom, 2000, p. 83). Vroom referred to organizational cultural boundaries within which leadership decision-making operates. Dickson, den Hartog, and Mitchelson (2003) provide insights into universal values and those that are culture specific—not only when compared between the west and the east, but within a region. For example, the decision-making processes prevalent in Korea and Japan, both Confucian nations, are different.

In studying the decision-making process and implementation of rules between the Thais and Japanese, Swierczek and Onishi (2003) also saw large differences in these two societies. While Thais prefer decisions to be made for them by leaders, decisions are meant to be flexible. The Japanese decision-making process is lengthy, and involves the participation of employees; decisions, once made, are rigid. Thus, decision-making is a much more crucial skill for Japanese leaders, in an environment where decisions are hierarchical and enduring. For these reasons, decision-making, an important aspect of MB, is investigated with regard to its influence on leadership excellence in the Mekong region. The following hypothesis is forwarded for testing.

Hypothesis 2

Decision-making influences the perception of what constitutes an excellent leader in Mekong organizations.

Managerial Behavior: Organizational Climate

Kozlowski and Doherty (1989, p. 546) assert that "climate and leadership are implicitly entwined." Grojean, Resick, Dickson, and Smith (2004, p. 224), quoting earlier works of Schneider (1975), say organizational climate "refers to perceptions of organizational practices and procedures that are shared among members and which provides an indication of the institutionalized normative systems that guides behavior." The shared perception and the way work is organized and carried out in an organizational setting then become the norm that guides the behavior of its people. In this regard, we are concerned with how the organization systems impacts behavior.

Organizational climate is therefore seen as the key operational link between the employee and the organizational environment (Kozlowski & Doherty, 1989). In the early literature (e.g., Sheridan & Vredenburgh, 1978), organizational climate was seen as a factor that constrained leadership behaviors. However, this view has changed, and organizational climate is now viewed as an "implicit aspect of leadership processes" (Kozlowski & Doherty, 1989, p. 547). Studying Thai employees' preferred leadership styles for their managers, Yukongdi (2010) referred to *kreng chai*, or taking cognizance of other persons' feelings, as an important aspect of the Thai organizational environment. In such an organizational climate, the importance of the individual within the work environment and interpersonal relationships becomes critical. Given this understanding, and based on the arguments above, we can assume that the organizational climate will influence leadership behavior in Mekong organizations, and forward the hypothesis as follows:

Hypothesis 3 Organizational climate influences the perception of what constitutes an excellent leader in Mekong organizations.

Managerial Behavior: Taking Initiative

Goerdel (2006, p. 351) postulated "that though network management contributes positively to organizational performance, theoretical work remains to answer how network management induces positive organizational outcomes." Crant (2000) added that proactive personality and personal initiative support proactive tendencies in organizations, describing four constructs related to proactive behavior: proactive personality, personal initiative, role breadth self-efficacy, and taking charge. It is this premise that this chapter also wishes to address—the concept of proactive management's having an influence on leadership excellence in the Mekong region.

Hypothesis 4 Taking initiatives influences the perception of what constitutes an excellent leader in Mekong organizations.

Organizational Demand: Deference for Authority

In leadership studies, the issue of authority relationships has been central (Casimir & Li, 2005; Graen, 2006; Lin, 2008). Presthus (1960, p. 86) defined authority "as the capacity to evoke compliance in others" and added that, in formal organizations, interpersonal relationships are "structured in terms of the prescribed authority of the actors." Therefore, while organizations are designed to achieve bigger goals, they must engage "instruments of motivation and direction to overcome the individual goals of their members."

A number of authors such as Selvarajah et al. (2013), Sriussadaporn-Charoenngam and Jablin (1999), Joiner, Bakalis, and Rattanapitan (2009) have pointed out that Thai people place a high value on deference to rank and respect for authority. Hofstede (1980) also observed a high power distance categorization for Thailand. The GLOBE study (Gupta, Hanges, & Dorfman, 2002) confirmed this observation. The support of deference for authority is not dissimilar to observations in Cambodia (see Selvarajah et al., 2012; Ojendal & Antlov, 1998). Ojendal and Antlov (1998) were of the view that the authority structure within Cambodian culture creates a superior-subordinate relationship in which loyalty and allegiance are based on hierarchy. Thus, it is hypothesized that:

Hypothesis 5 Deference for authority influences the perception of what constitutes an excellent leader in the Mekong organizations.

Personal Qualities

The social balance in Asian organizations is also based on respect for each individual's existence (Hilton, 1998). Therefore, balance is sought among authority, individual pursuit of achievement, and social interaction (Benveniste, 2000; Lamberton, 2005). In this context, individualism can be seen as an important personal quality that operates to provide balance, allowing the hierarchical mobility that Hilton (1998) emphasized; see Selvarajah et al. (2012) for evidence of individualism as a moderating variable within Cambodia, a collectivist society. This is also demonstrated for Thailand (Selvarajah et al., 2013). Taylor (1996, p. 19) expressed the view that the doctrine of non-violence embedded in Buddhism "is a call for a respect for the autonomy of each person, demanding a minimal use of coercion in human affairs."

Leadership studies have highlighted the importance of social order and as Rieff (1983, p. ix) stated "mirroring in each man the social order in which men act out their lives." For example, the Asian social system is based on social hierarchy that respects authority while maintaining fair and equal treatment within rank (e.g., Selvarajah et al., 2012, 2013; Sriussadaporn, 2006; Chen, 2004). Hank (1962), for example, analyzed merit and power in the Thai social order and suggested that the Thai hierarchy depends on merit (*boon*) or virtue (*khwaamdii*).

Conflict management is an important leadership function (Chen, Liu, & Tjosvold, 2005; Tse, Francis, & Walls, 1994). Researchers such as De Dreu and Van de Vliert (1997) have found that it is not how conflict is perceived that is important, but rather how constructively or destructively conflicts are managed. However, in many societies, especially collectivist countries in Asia, conflict tends to be avoided (e.g., Chen, 2004; Tse et al., 1994; Graham, Kim, Lin, & Robinson, 1988). Sriussadaporn-Charoenngam and Jablin (1999), and Deephuengton (1992) argued that Thais perceive non-confrontation as the most important part of their thought and behavior.

Reconciliation is difficult between disputing parties; this characteristic therefore places value on individual space within relationships, and this is also applicable in the workplace. Based on this understanding, the following hypothesis is forwarded for testing.

Hypothesis 6

Personal qualities reflecting morality, religion, interpersonal relationships and communication are important values in the Mekong culture and will influence managers' perception of what constitutes an excellent leader.

Environmental Influences: Environmental Harmony

Managing under conditions of uncertainty is a popular topic in management studies and important to leadership (e.g., Hofstede, 2007, Niffenegger, Kulviwat, & Engchanil, 2006; House et al., 2004). Thais tend to avoid uncertainty or the unknown, as it may lead them to awkward situations. Embarrassment due to uncertainty may prevent Thais from communicating freely. Thus, to adapt and communicate appropriately, Thais are more likely to find out what they should or should not do prior to engaging. According to Sriussadaporn-Charoenngam and Jablin (1999), for example, Thais tend to acquire information about the people they will be interacting with before meetings take place. Doing so helps them to create a pleasant situation and familiarity in the actual meeting. Khanittanan (1988) argued that Thais generally engage in overtly polite speech with strangers or people with whom they are not acquainted or about whose social status they are not certain.

This dislike of uncertainty can be expected to also impact the attention paid to harmony by the manager (Niffenegger et al., 2006). Given the attention for greater harmony, the Thai manager would monitor social trends, political changes, and international issues while abiding by the laws governing business operations. Selvarajah et al. (2012) found that Cambodia offers a work environment that is likely to be attractive to an international workforce. Vietnam is a fast-developing emerging economy, and the *doi moi* process has resulted in substantial achievements in economic growth and employment generation. Selvarajah et al. (2010) found that EIs (change monitoring and orientation) are important dimensions that pertain to excellence in leadership in Vietnam. To shorten the development gap between Vietnam and other countries in the region, the country has placed emphasis on the role of information and communication technology, and a report by Grant Thornton International, based on a survey of 7400 managers in 36 countries, ranked Vietnam first for profit growth in 2010 (Business Week, 2010). For this reason, it is expected that a Mekong leader who is socially and environmentally responsible, and one who monitors environmental issues closely, will be regarded favorably. The following hypothesis is forwarded for testing.

Hypothesis 7 Environmental harmony influences the perception of what constitutes an excellent leader in organizations in the Mekong countries.

Research Methodology

Data collection was carried out using the questionnaire developed by Selvarajah et al. (1995) in Thailand, Cambodia, Lao, and Vietnam. In Thailand, the data collection was in Bangkok, North Thailand, and East Thailand; in Cambodia, data were collected in Phnom Penh and Siem Riep; in Lao, data were collected in Vientiane, Luang Prabang, and Savannakhet; and, in Vietnam, data were collected in Hanoi and Ho Chi Minh City. The respondents were all practicing managers enrolled in MBA and other business masters programs at universities. Questionnaires were back-translated in all of the languages of the four Mekong countries. The Likert-type questionnaire had 94 items, with one representing "no importance" and five indicating "very important." Neither the respondents nor their organizations were required to be identified. Useable responses of 401 for Thailand, 217 for Cambodia, 208 for Vietnam provided, respectively, 50.1 %, 22 %, 75 % effective return rates. In Lao, through the Policy and Governance Institute, a snowball technique was applied to managers in the public and private sectors, providing responses from 207 participants.

In this research we developed scales for constructs using the framework for the characteristics of an EL, consisting of PQ, MB, ODs, and EIs (see the Appendix for details). The work of Selvarajah et al. (1995) provided the basis for these scales, but specific improvements were introduced. In particular, in order to produce discriminant validity between the scales, the "EL" statements were not included in any of the other four scales, and exploratory factor analysis was used to split the EL construct and the four Selvarajah et al. (1995) cultural dimensions into scales that reflect the contextual nature of the Mekong region. It was found that MB was composed of four of the constructs discussed above, namely organizational climate, effective decision-making and organizational commitment, and taking initiative, while EL was composed of two of the constructs discussed above, namely strategic leader and organizational leadership. Deference for authority, in this study, is defined as the way in which a manager responds to the goals, objectives, structures and issues in an organization (Selvarajah et al., 1995). This can be interpreted as the way in which a manager responds to organizational propriety and authority.

The reliability of the scales was assessed using Cronbach's α (see Table 18.3), and the internal validity of the scales assessed using confirmatory factor analysis (see the five tables in the appendix). The root mean squared error of approximation (RMSEA), a goodness of fit statistic (GFI), and a normed χ^2 statistic (CMIN/DF) suggest adequate internal validity (Arbuckle & Wothke, 1999) for all of the scales. All of reliability scores exceeded 0.6, and several 0.8, which makes the scales reasonably reliable (Hair, Anderson, Tatham, & Black, 1998).

An initial correlation analysis is used to assess whether the hypothesized dimensions are associated with perceptions of leadership, and structural equation modeling is then used to test the seven hypotheses, effectively

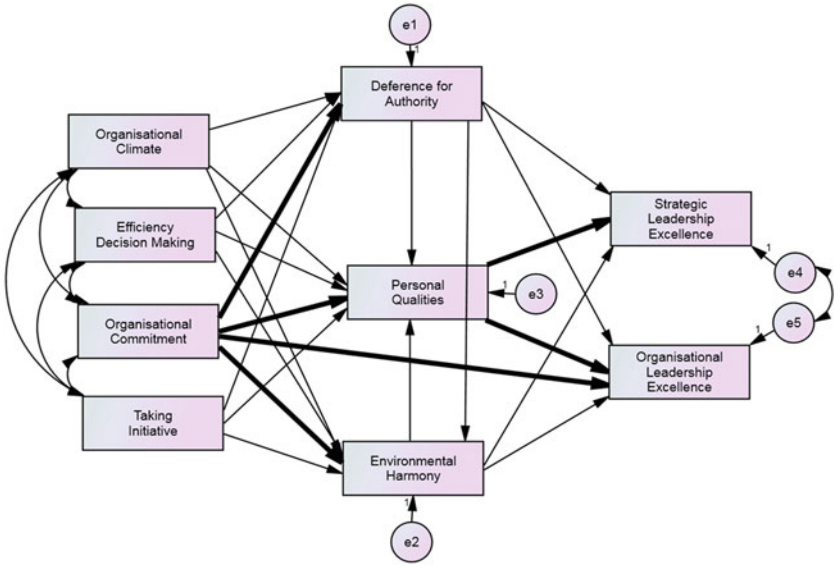


Fig. 18.1 Structural model for excellent leadership

validating the conceptual model proposed in Fig. 18.1. Finally, tests of invariance are performed in order to determine whether there are age and gender differences with regard to which characteristics are perceived as being important. A concerted effort is made to study subpopulation effects within nations and regions (e.g., see Selvarajah, 2008; Selvarajah & Meyer, 2008a, 2008b; Selvarajah et al., 2012, 2013).

Results

The results show substantial demographic differences among the four countries, with good gender balance in the case of Thailand and Vietnam but with younger managers for these countries and for Cambodia.The sample from Lao was older, and the majority of these managers were employed in government positions. The percentage of line managers was a little higher for Thailand than for the other countries and the percentage of managers employed in very large organizations (with more than 500 employees) was highest for Thailand. Vietnam had the largest percentage of employees working in small departments, with fewer than 11 employees, while Lao had a relatively low percentage of managers working in departments this small. Finally, Buddhism was by far the most common religion in Cambodia, Lao, and Thailand, but only 43 % of the Vietnamese managers were Buddhist, with most of the remaining Vietnamese managers claiming no religion.

Table 18.1 shows significant differences between the countries in most cases. In particular, organization climate is most important in Cambodia. Organizational commitment, deference for authority, PQ, environmental harmony, strategic leadership, and organizational leadership are particularly important in Lao. Taking initiative is particularly unimportant in Lao, especially compared to Vietnam.

Hypotheses 1–7 were initially examined by considering the correlations between the scales constructed using the tables shown in the appendix. Table 18.2 shows significant correlations between EL (strategic leadership and organizational leadership) and all of the other scales, providing some preliminary support for all of the hypotheses. Further support for the hypotheses was found in Fig. 18.1, a model that describes the relationship among the scales very well. However, organizational commitment is the only MB scale that has a direct impact on excellence in organizational leadership, while none of the MB scales has a direct impact on excellence in strategic leadership. In this research, PQ of the manager plays a key role, either directly or at least partially mediating the effect of all the other scales with regard to perceptions of excellence in strategic leadership and excellence in organizational leadership.

Table 18.1 Country comparison for scale means

	Cambodia	Laos	Thailand	Vietnam	$F(3,1029)$
Organizational climate	4.36	4.13	3.82	3.83	40.51***
Effective decision-making	3.74	3.86	3.90	3.84	2.63*
Organizational commitment	4.12	4.43	4.27	4.08	17.28***
Taking initiative	3.89	3.68	3.88	3.94	6.63***
Deference for authority	3.83	4.13	4.10	4.07	17.64***
Personal qualities	4.19	4.29	4.17	4.06	8.21***
Environmental harmony	3.87	4.15	4.03	3.78	20.24***
Strategic leadership	4.36	4.40	4.29	4.33	1.65
Organizational leadership	4.43	4.56	4.37	4.37	6.66***

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 18.2 Descriptive statistics and correlations for scales

	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*
Minimum	1.33	1.00	1.00	1.00	1.50	1.36	1.25	1.00	1.00
Maximum	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00	5.00
Mean	4.00	3.85	4.23	3.85	4.04	4.18	3.97	4.34	4.42
Std deviation	0.68	0.70	0.56	0.66	0.51	0.49	0.56	0.60	0.53
Cronbach's alpha	0.67	0.69	0.72	0.60	0.72	0.81	0.78	0.78	0.78
Organizational climate (1)	1								
Effective decision-making (2)	0.37**	1							
Organizational commitment (3)	0.45**	0.44**	1						
Taking initiative (4)	0.38**	0.37**	0.47**	1					
Deference for authority (5)	0.44**	0.47**	0.69**	0.55**	1				
Personal qualities (6)	0.58**	0.49**	0.80**	0.54**	0.72**	1			
Environmental harmony (7)	0.48**	0.46**	0.71**	0.51**	0.69**	0.73**	1		
Strategic leadership (8)	0.44**	0.38**	0.61**	0.43**	0.64**	0.66**	0.62**	1	
Organizational leadership (9)	0.45**	0.39**	0.76**	0.47**	0.66**	0.77**	0.65**	0.61**	1

n = 1033, ** $p < 0.001$

The structural model in Fig. 18.1 describes the data well (χ^2 = 12.03 with df = 7, p = 0.099, normed χ^2 = 1.719, GFI = 0.997, AGFI = 0.983, CFI = 0.999, TLI = 0.996). This model explains 66 % of the variation in organizational leadership excellence and 51 % of the variation in strategic leadership excellence. Clearly organizational commitment and PQ are key variables in this model.

MB, described in terms of organizational climate, efficiency of decision-making, organizational commitment and taking initiative, determines the importance attached to deference for authority, PQ, and environmental harmony, which in turn determine the excellence of a leader in both a strategic and in an organizational sense. Interestingly there is no direct relationship between the managerial behavior constructs and the EL constructs, except in one case in which organizational commitment is essential if a manager is to exhibit excellence in organizational leadership. See Tables 18.2 and 18.3 for more detail.

Table 18.3 Total standardized effect sizes

	Organization leadership excellence	Strategic leadership excellence
Organizational climate	0.10	0.13
Efficiency decision-Making	0.06	0.09
Organizational commitment	0.64	0.42
Taking initiative	0.09	0.14
Deference for authority	0.21	0.39
Personal qualities	0.38	0.31
Environmental harmony	0.12	0.26

Discussion

In this study, perceptions of what makes an EL in the Mekong region have been examined through the lenses of the four-dimensional framework suggested by Selvarajah et al. (1995) in their exploratory research of leadership excellence in Asia. The findings suggest that the four dimensions produced seven valid constructs, used to hypothesize the cultural phenomena observed in the Mekong organizations. To explain the EL, reliable scales have been developed for these constructs; overall ratings are high for all of these constructs, confirming their importance. In this Mekong-based study, two meaningful constructs—strategic leader and organizational leader—represent the concept of EL.

Correlation analysis suggested that the four dimensions of PQ, EI (harmony) and OD (deference for authority), and MB with four subconstructs of organizational commitment, taking initiative, effective decision-making, and organizational climate, are all associated with the two EL constructs (strategic and organizational). The structural equation model showed that organizational commitment had a direct relationship with the organizational leader construct, while the managers' PQ comprised the most important dimension in the Mekong countries, mediating, at least partially, the relationship of the MB constructs with the two EL constructs. As hypothesized, using scales validated with confirmatory factor analysis, structural equation modeling showed that all seven constructs had strong relationships with the two EL constructs. No attempt has been made to justify or interpret the PQ mediation effects suggested in Fig. 18.1. This is an area of much interest, in that it may help us to understand MB better regarding perceptions of excellence in leadership, and is therefore suggested for future research. What is interesting is that this study supports the relationship established in studies such as Avolio et al. (2004), Lok and Crawford (2004), and Loke (2001), between organizational commitment and organizational performance. Table 18.4 summarizes the support found for the hypotheses.

In this chapter, we have developed a nine-factor cultural model that supports excellence in leadership in the Mekong countries. The model shown in Fig. 18.1 shows that seven constructs—organizational climate, decision-making, organizational commitment, taking initiative, deference for authority, PQ, and environmental harmony—supported the two EL dimensions of strategic leadership and organizational leadership.

Implications for Theory and the Practice of International Business

First, any foreigner wishing to engage with the nationals of the Mekong countries must understand the extent to which MB (organizational climate, effective decision-making, organizational commitment, and taking initiative) are mediated by deference for authority, PQ of the managers, and environmental harmony. For example, the role of the monarch and the spiritual authority of the Buddhist religion have strong influences on the thinking and behavior of Thais at the national and personal levels. Although Thais show deference to the views of visitors, they are not judgmental, and are generally tolerant enough to accept differences in opinions, they will not tolerate disrespect to their King or open disrespect to their religion. Deference for authority is generally a strong value in Asian countries (Selvarajah et al., 2012).

Second, the EL has two faces that are closely related, to provide the measure for excellence in leadership in the Mekong organizations. First, managers are seen as wealth generators for the organization and as such their entrepreneurial nature, as envisaged by Zaccaro and Jimoski (2001), is an important value. The second face of the EL dimension is the strategic leader construct, which engages managers to provide strategic vision and to develop plans that will be sustaining and enduring for the organization's long-term prosperity.

Table 18.4 Support for hypotheses

Hypothesis	Total standardized effect size for leadership excellence: Organization	Total standardized effect size for leadership excellence: Strategic	Support
Hypothesis 1: *Commitment to the organization influences the perception of what constitutes an excellent leader in Mekong organizations*	0.64	0.42	Strong
Hypothesis 2: *Decision-making influences the perception of what constitutes an excellent leader in Mekong organizations*	0.06	0.09	Weak
Hypothesis 3: *Organizational climate influences the perception of what constitutes an excellent leader in Mekong organizations*	0.10	0.13	Weak
Hypothesis 4: *Taking initiatives influences the perception of what constitutes an excellent leader in Mekong organizations*	0.09	0.14	Weak
Hypothesis 5: *Deference for authority influences the perception of what constitutes an excellent leader in Thai organizations*	0.21	0.39	Weak/medium
Hypothesis 6: *Personal qualities reflecting, morality, religion, interpersonal relationships, and communication are important values in the Mekong culture and this will influence managers' perception of what constitutes an excellent leader*	0.38	0.31	Medium
Hypothesis 7: *Environmental harmony influences the perception of what constitutes an excellent leader in organizations in the Mekong countries*	0.12	0.26	Weak

Thirdly, the values of an organizational leader are mediated by managers' PQ. From a human resource management point of view, developing the PQ of managers in the Mekong is important for building up organizational capabilities. Understanding the impact that organizational commitment has on these PQ is crucial to understanding excellence in leadership. The managers' commitment to the organization also has a direct relationship with the organizational leader construct. Therefore, understanding and strengthening organizational commitment offer the potential for improving the strategic and organizational leader value outcomes, especially the latter.

Fourthly, MB, except in the case of organizational commitment, is related to EL (strategic and organizational) through the mediating constructs of deference for authority, PQ of managers, and environmental harmony. This has implications for practice as well as theory, as MBs on their own do not relate to leadership excellence. There are factors in the environment, authority structures, and contextual qualities of the manager that mediate the effects of MB with regard to what constitutes an EL.

Conclusion

The purpose of this study was to explore the influence of contextual factors on leadership behaviors in the Mekong region's organizations. The structural model utilized in this research was sufficiently robust to provide nine distinct cultural constructs that explained relationships between MBs and the conceptions of excellence in leadership in these Southeast Asian organizations. Value interpretations employing contextual and demographic variables were employed to relate these constructs to conceptions of an EL.

Evidence was found in this research to suggest that leadership excellence in Mekong organizations is predicted by the culture-based constructs of organization climate, effective decision-making, organizational commitment, taking initiative, deference for authority, PQ of the managers, and environmental harmony. Of these, organizational commitment and PQ of the manager stand out as being the strongest predictors of leadership excellence.

Appendices

Appendix 18.1 Excellent leader standardized regression weights

		Cambodia	Laos	Thailand	Vietnam	Overall
Organize work time effectively	F1	0.802	0.790	0.757	0.502	0.735
Continue to learn how to improve performance	F1	0.665	0.779	0.783	0.692	0.724
Develop strategies to gain competitive edge in the industry	F1	0.690	0.450	0.678	0.577	0.586
Have confidence when dealing with work and with people	F1	0.627	0.746	0.752	0.541	0.701
Motivate employees	F2	0.747	0.714	0.713	0.548	0.698
Give recognition for good work	F2	0.681	0.656	0.576	0.525	0.610
Have a strategic vision for the organization	F2	0.654	0.784	0.701	0.648	0.704
Create a sense of purpose and enthusiasm in the workplace	F2	0.579	0.710	0.721	0.719	0.660
Be honest	F2	0.607	0.669	0.600	*0.179*	0.528
RMSEA		0.048	0.057	0.050	0.103	0.031

F1 is a measure of strategic leadership, while F2 is a measure of organizational leadership

Test of invariance shows some evidence of a difference in weights for the four countries (χ^2 = 37.74, df = 21, p = 0.01). This can largely be explained with the low importance of honesty in Vietnam, resulting in a relatively poor fit for Vietnam. However, the overall model for excellent leader describes the Mekong data well (Normed χ^2 = 1.99, GFI = 0.99, AGFI = 0.98, TLI = 0.99, CFI = 0.99, RMSEA = 0.03)

Appendix 18.2 Personal qualities standardized regression weight

	Cambodia	Laos	Thailand	Vietnam	Overall
Speak clearly and concisely	0.762	0.755	0.676	0.600	0.708
Respect the self-esteem of others	0.572	0.632	0.695	0.588	0.619
Write clearly and concisely	0.603	0.646	0.553	0.526	0.587
Accept responsibility for mistakes	0.401	0.557	0.607	0.329	0.492
Follow what is morally right: not what is "right" for self or the organization	0.338	0.375	0.512	0.344	0.429
Listen to the advice of others	0.411	0.470	0.693	0.326	0.495
Be practical	0.506	0.325	0.620	0.394	0.491
Be an initiator—not a follower	0.387	0.529	0.585	0.261	0.486
Treat most people as if they were trustworthy and honest	0.513	0.533	0.564	0.246	0.499
Deal calmly with tense situations	0.428	0.606	0.595	0.413	0.530
Return favors	0.633	0.670	0.637	0.279	0.529
RMSEA	0.066	0.049	0.069	0.109	0.049

Although the model fit is obviously worse for Vietnam, a test of invariance shows no significant difference in the weights used for the four countries (χ^2 = 39.06, df

Appendix 18.3 Deference for authority standardized regression weights

	Cambodia	Laos	Thailand	Vietnam	Overall
Focus on maximizing productivity	0.418	0.455	0.439	0.296	0.408
Sell the professional or corporate image to the public	0.261	0.516	0.638	0.712	0.466
Support decisions made jointly by others	0.554	0.675	0.644	0.346	0.600
Adapt to changing working conditions	0.410	0.430	0.519	0.197	0.420
Adjust organizational structures and rules to the realities of practice	0.493	0.636	0.532	0.467	0.538
Act as a member of the team	0.483	0.493	0.609	0.308	0.549
Share power	0.644	0.551	0.661	0.423	0.560
Give priority to long-term goals	0.543	0.550	0.429	0.424	0.446
RMSEA	0.040	0.089	0.067	0.080	0.050

Although the fit was clearly worse for Laos and Vietnam, an invariance test showed no significant difference among the weights for the four countries (χ^2 = 28.977, df = 21, p = 0.115)

= 30, p = 0.12)

Appendix 18.4 Environmental harmony standardized regression weights

	Cambodia	Laos	Thailand	Vietnam	Overall
Be socially and environmentally responsible	0.685	0.645	0.561	0.548	0.624
Identify social trends which may have an impact on work	0.564	0.600	0.677	0.399	0.586
Be responsive to political realities in the environment	0.391	0.348	0.552	0.331	0.444
Foster an international perspective in the organization	0.592	0.585	0.594	0.513	0.599
Have a multi-cultural orientation and approach	0.593	0.364	0.632	0.647	0.568
Use economic indicators for planning purposes	0.548	0.466	0.606	0.415	0.537
Study laws and regulations which may have an impact on work	0.546	0.586	0.606	0.416	0.565
Check consistently for problems and opportunities	0.566	0.560	0.636	0.284	0.552
RMSEA	0.074	0.043	0.070	0.073	0.057

No significant difference in the weights required for the four countries (χ^2 = 30.570, df = 21, p = 0.081)

Appendix 18.5 Managerial behavior standardized regression weights

		Cambodia	Laos	Thailand	Vietnam	Overall
Think about the specific details of any particular problem	F1	0.752	0.678	0.656	0.863	0.717
Tell subordinates what to do and how to do it	F1	0.682	0.628	0.674	0.790	0.734
Be strict in judging the competence of employees	F1	0.468	0.525	0.535	0.319	0.502
Make decisions without depending too much on others	F2	0.530	0.616	0.635	0.519	0.564
Make work decisions quickly	F2	0.649	0.716	0.765	0.603	0.699
Make decisions earlier rather than later	F2	0.673	0.623	0.792	0.588	0.694
Select work wisely to avoid overload	F4	0.557	0.691	0.627	0.245	0.577
Persuade others to do things	F4	0.402	0.626	0.589	0.411	0.540

		Cambodia	Laos	Thailand	Vietnam	Overall
Listen to and understand the problems of others	F4	0.662	0.670	0.682	0.631	0.660
Be objective when dealing with work conflicts	F4	0.650	0.514	0.623	0.391	0.547
Keep up-to-date on management literature	F4	0.472	0.713	0.672	0.691	0.608
Use initiatives and take risks	F3	0.535	0.702	0.769	0.620	0.684
Try different approaches to management	F3	0.607	0.746	0.729	0.678	0.703
Delegate	F3	0.550	0.376	0.405	0.414	0.424
RMSEA		0.069	0.056	0.057	0.081	0.047

F1 measures "Organization climate." F2 measures "Efficiency of decision-making." F3 measures "Taking initiative." F4 measures "Organizational commitment"

An invariance test showed significant differences among the weights for the four countries ($\chi^2 = 49.477$, df = 30, $p = 0.014$). In particular, the loading for "Select work wisely in order to avoid overload" is relatively low for Vietnam

References

Arbuckle, J. L., & Wothke, W. (1999). *AMOS 4.0 user's guide*. Chicago: Small Waters Corporation.

Avolio, B. J., Zhu, W., Koh, W., & Bhatia, P. (2004). Transformational leadership and organizational commitment: Mediating role of psychological empowerment and moderating role of structural distance. *Journal of Organizational Behavior, 25*(8), 951–968.

Benveniste, J. (2000). Quality of work, home and community life. In J. B. D. Dunphy, A. Griffith, & P. Sutton (Eds.), *Sustainability*. Sydney: Allen & Unwin.

Brewer, P., & Venaik, S. (2010). GLOBE practice and values: A case of diminishing marginal utility? *Journal of International Business Studies, 41*, 1316–1324.

BusinessWeek (2010). Vietnam is no 1 for profit growth in 2010, says survey. February 27. http://www.dtinews.vn/en/news/018/1535/vietnam-is-no--1-for-profit-growth-in-2010--says-survey.html. Accessed 20 February 2016.

Casimir, G., & Li, Z. (2005). Combinative aspects of leadership style: A comparison of Australian and Chinese followers. *Asian Business and Management, 4*(3), 271–291.

Chandler, D. (1998). *A history of Cambodia*. Bangkok: Silkworm Books.

Chen, G., Liu, C., & Tjosvold, D. (2005). Conflict management for effective top management teams and innovation in China. *Journal of Management Studies, 42*(1), 276–300.

Chen, M. (2004). *Asian management systems: Chinese, Japanese and Korean styles of business*. London: Thompson Learning.

Chhokar, J. S., Brodbeck, F. C., & House, R. J. (2007). *Culture and leadership across the world: The GLOBE book of in-depth studies of 25 societies*. London: Routledge.

Crant, J. M. (2000). Proactive behaviour in organizations. *Journal of Management, 26*(3), 435–462.

Cuong, D. M., & Swierczek, F. W. (2008). Corporate culture, leadership competencies, job satisfaction, job commitment, and job performance: A comparison of companies in Vietnam and Thailand. *Journal of American Academy of Business, 13*(1), 159–165.

De Dreu, C. K. W., & Van de Vliert, E. (1997). *Using conflict in organizations*. London: Sage.

De Waal, A. A., Van der Heijden, B. I. J. M., Selvarajah, C., & Meyer, D. (2012). Characteristics of high performing managers in The Netherlands. *Leadership and Organization Development Journal, 33*(2), 131–148.

Deephuengton, P. (1992). *Politeness in Thai: Strategies of refusing and disagreeing*. Unpublished Doctoral Dissertation, University of Kansas.

Dickson, M. W., den Hartog, D. N., & Mitchelson, J. K. (2003). Research on leadership in a cross-cultural context: Making progress, and raising new questions. *The Leadership Quarterly, 14*, 729–768.

Fairhurst, G. T. (2009). Considering context in discursive leadership research. *Human Relations, 62*(11), 1607–1633.

Goerdel, H. T. (2006). Taking initiative: Proactive management and organizational performance in networked environments. *Journal of Public Administration Research and Theory, 16*(3), 351–367.

Graen, G. B. (2006). In the eye of the beholder: Cross cultural lessons in leadership from Project GLOBE. *The Academy of Management Perspectives, 20*(4), 95–101.

Graham, J. L., Kim, D. K., Lin, C., & Robinson, M. (1988). Buyer-seller negotiations around the Pacific Rim: Differences in fundamental exchange processes. *Journal of Consumer Research, 15*, 48–54.

Grojean, M. W., Resick, C. J., Dickson, M. W., & Smith, D. W. (2004). Leaders, values, and organizational climate: Examining leadership strategies for establishing an organizational climate regarding ethics. *Journal of Business Ethics, 55*, 223–241.

Gupta, V., Hanges, P. J., & Dorfman, P. (2002). Cultural clusters: Methodology and findings. *Journal of World Business, 37*, 11–15.

Gupta, V., Surie, G., Javidan, M., & Chhokar, J. (2002). Southern Asia cluster: Where the old meets the new. *Journal of World Business, 37*, 16–27.

Hair, J. F., Anderson, R. E., Tatham, R. L., & Black, W. C. (1998). *Multivariate data analysis*. Upper Saddle River, NJ: Prentice-Hall.

Hanks L. (1962). Merit and power in the Thai social order. *American Anthropologist*, 64, 1247–1261.

Hilton, A. L. (1998). Why did I kill? The Cambodian genocide and the dark side and face honor. *Journal of Asian Studies, 57*(1), 93–122.

Hofstede, G. (1980). *Culture's consequences: International differences in work-related values*. Beverly Hills, CA: Sage.

Hofstede, G. (1984). *Culture's consequences: International differences in work-related values*. Beverly Hills, CA: Sage.

Hofstede, G. (2007). Asian management in the 21st century. *Asia Pacific Journal of Management, 24*(4), 411–420.

House, R. J., Hanges, P. J., Javidan, M., Dorfman, P. W., & Gupta, V. (2004). *Culture, leadership, and organizations: The GLOBE study of 62 societies*. London: Sage Publications.

Joiner, T. A., Bakalis, S., & Rattanapitan, G. (2009). The traditional leadership in Thailand: The role of applying abilities for mutual benefit. *International Journal of Business and Economics, 9*(1), 85–92.

Kennedy, J. C. (2002). Leadership in Malaysia: Traditional values, international outlook. *Academy of Management Executive, 16*(3), 15–25.

Khanittanan, W. (1988). Some observations on expressing politeness in Thai. *Language Science, 10*(2), 353–362.

Kozlowski, S. W. J., & Doherty, M. L. (1989). Integration of climate and leadership: Examination of a neglected issue. *Journal of Applied Psychology, 74*(4), 546–553.

Lamberton, G. (2005). Sustainable sufficiency – An internally consistent version of sustainability. *Sustainable Development, 13*, 53–68.

Lin, C. (2008). Demystifying the chameleonic nature of Chinese leadership. *Journal of Leadership and Organizational Studies, 14*(4), 303–321.

Linden, R. C., & Antonakis, J. (2009). Considering context in psychological leadership research. *Human Relations, 62*(11), 1587–1605.

Lok, P., & Crawford, J. (2004). The effect of organisational culture and leadership style on job satisfaction and organisational commitment. *Journal of Management Development, 23*(4), 321–338.

Loke, J. C. F. (2001). Leadership behaviours: Effects on job satisfaction, productivity and organizational commitment. *Journal of Nursing Management, 9*(4), 191–204.

McCrae, R. R., Terracciano, A., Realo, A., & Allik, J. (2008). Interpreting GLOBE societal practices scales. *Journal of Cross-Cultural Psychology, 39*, 805–810.

McSweeney, B. (2002). Hofstede's model of national cultural differences and their consequences: A triumph of faith—A failure of analysis. *Human Relations, 55*(1), 89–118.

Minkov, M., & Blagoev, V. (2012). What do Project GLOBE's cultural dimensions reflect? An empirical perspective. *Asia Pacific Business Review, 18*(1), 27–43.

Niffenegger, P., Kulviwat, S., & Engchanil, N. (2006). Conflicting cultural imperatives in modern Thailand: Global perspectives. *Asia Pacific Business Review, 12*(4), 403–420.

Ojendal, J., & Antlov, H. (1998). Asian values and its political consequences: Is Cambodia the first domino? *The Pacific Review, 11*(4), 525–540.

Pawar, B. S., & Eastman, K. K. (1997). The nature and implication of contextual influences on transformational leadership: A conceptual examination. *Academy of Management Review, 22*(1), 80–109.

Presthus, R. V. (1960). Authority in organizations. *Public Administration Review, 20*(2), 86–91.

Rieff, P. (1983). Introduction. In C. H. Cooley & P. Rieff (Eds.), *Human nature and the social order*. New York: Transaction Publishers.

Schneider, B. (1975). Organizational climates: An essay. *Personnel Psychology*, 28, 447–479.

Selvarajah, C. (2008). Cultural diversity management in Malaysia: A study of Indian, Chinese and Malay business leadership. In K. J. R. Amar Nayak & M. C. Jomon (Eds.), *India in the emerging global order* (pp. 267–282). New Delhi: Taj McGraw Hill.

Selvarajah, C., Duignan, P., Lane, T., Nuttman, C., & Suppiah, C. (1995). In search of the Asian leader: An exploratory study of dimensions that relate to excellence in leadership. *Management International Review, 35*(1), 29–34.

Selvarajah, C., & Meyer, D. (2008a). One nation, three cultures: Exploring dimensions that relate to leadership in Malaysia. *Leadership and Organizational Development Journal, 29*(8), 693–712.

Selvarajah, C., & Meyer, D. (2008b). Profiling the Chinese manager: Exploring dimensions that relate to leadership. *Leadership and Organizational Development Journal, 29*(4), 359–375.

Selvarajah, C., Meyer, D., Davuth, D., & Donovan, J. (2012). The effect of cultural modelling on leadership profiling of the Cambodian manager. *Asia Pacific Business Review, 18*(4), 1–26.

Selvarajah, C., Meyer, D., & Donovan, J. (2013). Cultural context and its influence on managerial leadership in Thailand. *Asia Pacific Business Review, 19*(3), 356–380.

Selvarajah, C., Meyer, D., & Jeyakumar, R. (2011) Profiling excellence in leadership in Singapore – Shifting values. *Proceedings of the Academy of International Business (AIB) SEA Chapter*. 1–3 December, Taipei, Taiwan.

Selvarajah, C., Meyer, D., Vinen, D., & Pham, Q. T. (2010) In search of excellence in leadership in the Vietnamese manager: Where Confucianism meets Dharma. *Proceedings of the Academy of International Business (AIB) SEA Chapter*. 2–4 December, Ho Chi Minh City, Vietnam.

Sheridan, J. E., & Vredenburgh, D. J. (1978). Predicting leadership behavior in a hospital organization. *Academy of Management Journal, 21*, 679–689.

Shi, X., & Wang, J. (2011). Interpreting Hofstede model and GLOBE model: Which way to go for cross-cultural research. *International Journal of Business and Management, 6*(5), 93–99.

Shrivastava, S., Selvarajah, C., Meyer, D., & Dorasamy, N. (2014). Exploring excellence in leadership perceptions amongst South African managers. *Human Resource Development International, 17*(1), 47–66.

Sriussadaporn, R. (2006). Managing international business communication in companies in Thailand. *Cross Cultural Management, 13*(4), 330–344.

Sriussadaporn-Charoenngam, N., & Jablin, F. (1999). An exploratory study of communication competence in Thai organizations. *The Journal of Business Communication, 36*, 382–418.

Swierczek, F. W., & Onishi, J. (2003). Culture and conflict: Japanese managers and Thai subordinates. *Personnel Review, 32*(2), 187–210.

Tannenbaum, R., & Schmidt, W. (1973, May–June). How to choose a leadership pattern. *Harvard Business Review*, 3–12.

Taormina, R., & Selvarajah, C. (2005). Perceptions of leadership excellence in ASEAN nations. *Leadership, 1*(3), 299–322.

Taras, V., Steel, P., & Kirkman, B. (2010). Negative practice-value correlations in the GLOBE data: Unexpected findings, questionnaire limitations and research directions. *Journal of International Business Studies, 41*, 1330–1338.

Taylor, C. (1996). A world consensus on human rights? *Dissent, 43*, 20.

Tse, D. K., Francis, J., & Walls, J. (1994). Cultural differences in conducting intra- and inter-cultural negotiations: A Sino-Canadian comparison. *Journal of International Business Studies, 24*, 537–555.

Tung, R. L., & Verbeke, A. (2010). Beyond Hofstede and GLOBE: Improving the quality of cross-cultural research. *Journal of International Business Studies, 41*(8), 1259–1274.

Venaik, S., & Brewer, P. (2010). Avoiding uncertainty in Hofstede and GLOBE. *Journal of International Business Studies, 41*(8), 1294–1315.

Vroom, V. H. (2000). Leadership and the decision-making process. *Organizational Dynamics, 28*(4), 82–94.

Vroom, V. H., & Yetton, P. W. (1973). *Leadership and decision-making*. Pittsburgh, PA: University of Pittsburgh Press.

Yousef, D. A. (2000). Organizational commitment as a mediator of the relationship between Islamic work ethic and attitudes toward organizational change. *Human Relations, 53*(4), 513–537.

Yukl, G. A. (2005). *Leadership in organizations*. New York: Prentice Hall.

Yukongdi, V. (2010). A study of Thai employees' preferred leadership style. *Asia Pacific Business Review, 16*(1–2), 161–181.

Zaccaro, S., & Jimoski, R. J. (2001). *The nature of organizational leadership: Understanding the performance imperatives confronting today's leaders*. San Francisco: Jossey-Bass.

Part VI

Doing Well or Doing Good? Two Views of CSR in India

19

Mandated Corporate Social Responsibility (mCSR): Implications in Context of Legislation

Kajari Mukherjee

Introduction

Corporate social responsibility (CSR) exemplifies the interdependent nature of business and society, and the role of business to be responsible in creating a better future and use resources in ways to benefit society (Snider, Hill, & Martin, 2003). Definitions of CSR are many (e.g., Carroll, 1999; Kakabadse, Kakabadse, & Rozuel, 2007; Valor, 2005), though they all share the commonality that business should not just concentrate on being responsible to its shareholders. Carroll (1979) conceptualized CSR as four types of responsibilities of businesses. The economic component obligates a business to perform well, the legal component requires them to obey the law, the ethical component enjoins them to abide by society's ethical standards, and the philanthropic component

K. Mukherjee (✉)
Indian Institute of Management Indore, Indore, India
e-mail: kajari@iimidr.ac.in

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_19

expects them to give back to the society in some form. The components are not mutually exclusive. The CSR perspective assumes that business will focus on all four as a unified whole, through decisions, actions, policies, and practices that simultaneously fulfill all its component parts (Carroll & Buchholtz, 2006). Thus, CSR is recognized to have a strong discretionary component, beyond what is required by law and what is deemed right. Matten and Moon (2008) argue that CSR should be perceived both as a social imperative and social consequence of business success, and the operative definition depends on specific historic, cultural, and political factors of the geography where business operates. This allows for the dynamic nature of CSR, as its content evolves over time contingent on changes in the degree of risk, regulation, reputational challenge, and standards of desirable behavior accepted in the society (Baxi, 2005). This also allows conceptualizing various approaches to CSR based on the interaction between business and society—instrumental (CSR as mere end to profits), political (CSR that recognizes power of the company), integrative (CSR as the company's assumption of social demands), and ethical (CSR as ethical obligation of the company) (Garriga & Mele, 2004). Further dynamic conceptualization of responsibilities of business also allows for argument that the CSR agenda for developing countries is likely to be markedly different based on contextual and cultural factors and priorities of society (e.g. Gugler & Shi, 2008; Idemudia, 2011; Jamali & Neville, 2011; Lund-Thomsen, 2004).

Worldwide, in the last decade and half, governments are increasingly involved in promoting and encouraging businesses to adopt pro-CSR stance (e.g., Albareda, Lozano, Tencati, Midttun, & Perrini, 2008; Zadek, 2002). Governments actively provide an enabling environment in extending CSR, especially in delivering against public policy goals and priorities (Fox, Ward, & Howard, 2002). Governments adopt four different roles to encourage CSR: mandating role through legislating, facilitating role through creating guidelines on content, fiscal support and frameworks for voluntary action; partnering role by engaging in multi-stakeholder processes to build capacity, and endorsing role through political support and publicity (*ibid*). In its mandating role, government actions range from conventional social and environmental hard-law regulations to soft-law related to voluntary self-regulation and reporting. Soft legislation refers to quasi-legal requirements that are not legally binding. Soft law developments in European Union regarding CSR mean that "its (law's) influence lies in how they influence, rather than control, the behavior of corporations … (though) it is not entirely without hard legal efficacy; a number of directives refer to soft law standards as informing their application" (Croquet, Hameed, & Yalkin, 2009, p. 2). Soft law does have practical effects, as it is expected to be implicitly binding. For example, in the UK, soft law involves encouragement of CSR through ministerial leadership, closer public–private partnership to deliver social well-being, and subsidizing CSR activities by changes in tax laws to encourage corporate philanthropy (Albareda, Tencati, Lozano, & Perrini, 2006; Joseph, 2001; Moon, 2004). On the other hand, countries, notably those in middle- and low-income levels and facing major social challenges, have explicitly sought engagement with business in meeting those through forms of *hard* regulations. Some such examples are Black Economic Empowerment program (South Africa), Presidential encouragement of business efforts to tackle poverty (Philippines), and Citizens Economic Empowerment (Zambia) (UNDESA, 2007). Some other countries are mandating to corporate sector to allocate and spend an *obligatory amount* for implementing CSR. For example, in Indonesia, companies engaged in natural resources or the forestry sector are expected to allocate and spend an (undefined) obligatory amount for implementing CSR, which can be considered as an operational cost (Waagstein, 2011). India has mandated in 2013 that companies of certain size have to spend 2 percent of their profit on philanthropy.

Thus, the altruistic credo of business to do good for the society over and above legal and ethical requirements is coming under mandating role of the government. We call this aspect as mandated CSR (mCSR), that is, doing good for the society as mandated by legislation. While business insists that CSR be a voluntary commitment but other societal stakeholders like government, non-governmental organizations (NGOs) and civil societies, trade unions, and consumers are increasingly putting on a range of responsibilities on the shoulder of business. Many of these, sometimes representing different expectations from different interest groups, are those which cannot be pursued through existing legal and judicial frameworks. The concept of mCSR links those expectations to requirements under either soft law or hard law.

Expectation from Business: By Governments with Pressing Developmental Needs

In respect of middle- and low-income countries, it is increasingly being suggested that governments of such countries should set the CSR agenda for themselves, by recognizing potential contribution from CSR and aligning it with national development goals (UNDESA, 2007). Middle- and low-income countries are beset with a low per capita income, and low level of human capital index; their social and environmental challenges are distinctive, and the political will and administrative ability to tackle these differ widely. The mainstream CSR agenda is largely driven by concerns and priorities of developed countries and ignores the local realities such as social (e.g., poor access to capacity-building), political (e.g., poorly developed democratic institutions), and economic (e.g., tax avoidance and poor legal enforcements) challenges. It aims at universalizing a set of conditions that does not exist in middle- and low-income countries and ignores the wider ramifications of CSR demands on the very people it seeks to protect, inadvertently harming them (Idemudia, 2011). Visser (2008) identifies six internal drivers of CSR in such countries, namely cultural traditions, political reform, socio-economic priorities, governance gaps, crisis response, and market access. As example of India and Indonesia—the second and fourth largest countries of the world based on population—indicates, such countries are incorporating hard legislation to mandate CSR by business.

With conceptualization of CSR undergoing a change with increasing legislation—both hard and soft—in what was expected to be the discretionary responsibility of the business, we discuss in the present chapter the implications and problems associated with mCSR using the context of the Indian legislation. In the next section, we describe the Indian legislation and explain how it is a definitive and bold move toward underpinning obligations of business toward society in general. Then we discuss the implications and problems that are likely to be inherent in making philanthropy mandatory. Last section discusses the ameliorative steps that can ensure that mCSR delivers content as intended.

Hard Legislation on CSR in India

India is the first country to legislate mandatory involvement of business organizations in the process of development of the society through CSR. Section 135 of The Companies Act, 2013[1] mandates:

> *135 (1) Every company having net worth of rupees*[2] *five hundred crore*[3] *or more, or turnover of rupees one thousand crore or more or a net profit of rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.*
>
> …
>
> *(3) The Corporate Social Responsibility Committee shall, (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII.*
>
> …
>
> *(5) The Board of every company referred to in sub-section (1) shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.*
>
> *Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.*

Total CSR funds thus generated amounts to an estimated $2 billion per annum.[4] The government expects companies to spend this amount on various CSR activities, detailed in Schedule VII of the said Act. The said schedule lists these as eradicating extreme hunger and poverty; promoting education; promoting gender equality and empowering women; reducing child mortality and improving maternal health; combating human immunodeficiency virus, acquired immune deficiency syndrome,

[1] http://indiacode.nic.in/acts-in-pdf/182013.pdf, accessed on 28th February 2014.

[2] One USD = 62 Rupees on 28th February 2014.

[3] One crore = 10 million.

[4] http://articles.economictimes.indiatimes.com/2013-08-13/news/41374893_1_sirohi-india-inc-social-sector/2, accessed on 28th February 2014.

malaria and other diseases; ensuring environmental sustainability; enhancing employment-linked vocational skills; supporting social business projects; and contributing to funds set up by the government to help various historically disadvantaged groups of the society including women and marginalized communities.

Under mCSR in India, the companies are free to utilize their funds as they deem fit for philanthropic activities like building schools, organizing health camps, planting trees, and so on, leading to reputational legitimacy, trust, and reciprocity from local communities. Thus, mCSR serves a dual purpose: it allows the government to force business to support social welfare, as well as pleases companies by avoiding additional taxes (Zile, 2012). There are no punitive steps prescribed for not spending CSR funds, but reasons for not doing so are required to be disclosed in the Annual Report. Thus, mandatory expenditure by companies is monitored entirely through public disclosure.

The mCSR of India is a definitive and bold move toward underpinning the obligations of business toward society in general. By defining minimum standards for company contribution to philanthropy, the government aims to ensure that business lives up to the expectation of creating social good, along with creating economic profit. It allows the government to harness potential positive benefits of CSR by integrating it with public policy discourses, in line with its commitment to create equity in a socialist, democratic republic.

CSR in India

India has a long tradition of philanthropy based on the rich and nuanced cultural and religious tradition of the country. Home-grown Indian companies have engaged in corporate philanthropy since the advent of industrialization in the country. A prime example is that of the salt-to-software multinational conglomerate of Tata Groups, with market capital of close to $100 billion of its listed companies; 66 percent of shares of its holding company were bequeathed to various trusts since its founding more than a hundred years ago.[5] The first iron and steel plant of the Group

[5] http://www.tata.com/company/profile/Tata-Sons, accessed on 28th February 2014.

had an eight-hour work-shift since its inception in 1911, when factories in Europe and North America still had a minimum of 10- or 12-hour days. The foremost thought leader of the twentieth century, Mahatma Gandhi, conceived business as a trusteeship wherein the business owners consider part of their wealth in excess of their needs as being held in trust for the larger good of society, and act accordingly (Gandhi, 1939). The trusteeship concept of Gandhi is proactive and intends at transformation whereby the business sees itself using its assets for the benefit of the society, as well as following a moral path in its conduct of business (Gopinath, 2005); this concept has served as a model for many business leaders both during pre- and post-independence (India gained freedom in 1947), the example of the Tata Group being one.

The Indian business society, in modern times, is seen as a complex mix of traditional values and dimensions of contemporary global market imperatives (Chatterjee & Pearson, 2000). This is reflected in mixed expectations from CSR. For example, Balasubramanian, Kimber, and Siemensma, (2005, p. 86) found that there is a clear dichotomy emerging in socio-economic space regarding role of CSR in modern India—on one hand "there is a strong belief that CSR is an essential element in 'social uplift' and development, something very relevant to India, but less emphasized in US, UK or Western European nations", and on the other "this may indicate a potential tension which could emerge if CSR policy development is driven by a 'link-to-business-objectives' focus—employee satisfaction, urban needs, transport and so on—while the more pressing traditional issues as noted above remain 'out in the cold'". The study also found that deep integration of CSR in mainstream business is scarce, and CSR practice is both reactive and "caring" focused. A more recent study of the top 500 companies in India finds that 229 did not report on CSR activities; the remaining appear to make generally token gestures toward CSR, with funds spread thinly across many activities, and only a few have structured and planned approach (Gautam & Singh, 2010). This study further finds that companies define CSR in distinctive ways as per their own needs, and that it is primarily driven by philanthropy. A comparatively recent study on CSR as practiced by international companies in India found that "profoundness of the commitment varies according to their experience and knowledge of the issue, and a lack of coherence among companies and stakeholders regarding the understanding of, and engagement in, the issue is evident. In its contemporary stage, the development impact of the CSR strategies can be seen as rather modest" (Shankar, Chadwick, Ghafoor, & Khan, 2011, p. 97).

The Indian experience regarding CSR indicates that though, conceptually, business agrees that CSR is important and should be philanthropic in nature based on traditional values, in reality, delivery has been patchy. Also, the expectation of society from companies is diverse—ranging from developmental needs to pragmatic needs of business (Balasubramanian et al., 2005). Drawing a distinction between CSR that has 'link-to-business-objectives' focus, or is more directly linked to business goals like revenue-generation and profitability, and that done for the good of society without any obvious return, the government of India has introduced its legislation on CSR. It makes CSR aimed at mitigating problems in the society mandatory. The emphasis is purely on philanthropy—it is clearly stated that any surplus arising out of CSR activities has to be farmed back into CSR corpus, and cannot be offset by the mandated two percent of average net profits.[6] The Indian legislation on mCSR is likely to become a template for other countries dealing with pressing developmental needs in institutionalizing CSR in the form of legal obligations. Most middle- and low-income countries share similar socio-political-cultural-infrastructural-administrative challenges. Thus, discussing problems and implications of mCSR in the context of Indian legislation has ramifications for other such countries as well.

Problems and Implications of mCSR

The relationship between legislation and company compliance is complex (Waagstein, 2011), and the two do not necessarily coincide. India has a plethora of laws regarding safety and care of important stakeholders to business, viz., employees, customers, vendors, environment, and

[6] The Corporate Social Responsibility Rules under Section 135 of the Companies Act, 2013, was notified on 28th February, 2014, and comes into effect from 1st April 2014. The financial year in India is from 1st April to 31st March.

society. These detail what businesses should or should not do, though implementation is often problematic and is seen as inimical to running a business. An overloaded judicial system, overlap among different laws, antediluvian nature of laws (i.e., not in sync with changing realities), and corruption impair the effectiveness of law as "mock-compliance" (i.e., merely in form) is common. As India tries to find an optimum ground in between challenges of socialistic welfare and economic drivers of economy, mCSR has been designed to force large companies to share the state's responsibility of providing some of the basic amenities of dignified human existence in respective local communities.

The challenge of mCSR lies not in intent but in delivery of the intent. We raise questions in the next section of it being effective, cost beneficial, and competitive; our contention being that till business is fully satisfied with the answers, intent of the legislation may not be converted into appropriate action. Thereafter, we discuss some ways of amelioration of the problems and implications of mCSR.

Will mCSR Be Effective?[7]

The legislation in India is based on the concept of stakeholder theory (Freeman, 1984). Business has to accept that, apart from shareholders, there are other stakeholders to the business and the company is beholden to look after them as each have an "intrinsic value" (Donaldson & Preston, 1995, p. 67)—this is the normative version of CSR. As per Indian legislation, a committee of the Board will create the CSR policy and monitor the implementation. However, according to the agency theory, managers are engaged, actively monitored, and incentivized by the principals (owners/shareholders) to run the business profitably (Eisenhardt, 1989). Based on the agency theory, most managers are not likely to find *intrinsic value* in all stakeholders; rather, they are likely to attend to those stakeholders who have the power to reward and/or punish them. These are likely to

[7] Waagstein (2011) has dealt with these three questions while discussing mandatory CSR in context of Indonesia. However, the legislation is restricted to only those companies which deal in natural resources (definition is open-ended), quantum of obligatory spending is not defined and cost of CSR can be considered as a corporate cost.

include those who do not have legitimate stake in the business but have attributes of power and urgency, labeled as 'dangerous' by Mitchell, Agle, and Wood (1997). CSR money can actually go into buying support of 'dangerous' stakeholder for the business, in guise of espousing the cause of the poor and underprivileged. This can be in the form of patronage extended to local political and social elites—by helping institutions and causes in which they are interested, or supporting non-governmental organizations and civil societies that tend to make maximum *noise*. The business may see this approach to buy support or silence of stakeholders, typically that of the dangerous variety, as an easy route, rather than investing in long-term supportive relationships, or genuinely working through to alleviate the cause of concern. Thus, the legislation may lead to increase in self-interest-driven behavior or act as "a valuable entrenchment tool for incumbent managers" as Cespa and Cestone (2007, p. 742) found in their study that relations with social activists may become an effective entrenchment strategy for inefficient CEOs.

The other danger of buying off dangerous stakeholders is even more painful. The stakeholders, who started off espousing a genuine cause of the society, for example, mining in an environmentally sensitive area, may be silenced and there will be no one left to take up the case on behalf of the stakeholder. For example, Fooks, Gilmore, Collin, Holden, and Lee (2013, p. 284) argue that tobacco companies use CSR as a political tool to prevent introduction of punitive legislations, as managers use "CSR to broker access to public officials, influence the policy alternatives under consideration by elected representatives, break up opposing political constituencies".

The present legislation, based on stakeholder theory, does not provide any "principled criterion for decision making" (Jensen, 2010, p. 36). Thus, managers are likely to formulate, adopt and implement those CSR projects which add on to their personal glory or are closer to their personal interest in the form of psychological egoism or add to their reputation as good global citizens in the eyes of various stakeholders (Hemingway & Maclagan, 2004). For example, Barnea and Rubin (2010) found that managers induce companies to over-invest in CSR when they themselves bear little of the cost of doing so.

Continuity of any CSR initiative may be an issue, and with successive regime change, CSR activities may end up representing flavor of the season. Even within the overall CSR policy document, it is likely that projects picked up necessarily do not reflect the optimum choice. Thus, the present legislature may promote mismanagement of funds. Managers, being the most important stakeholder in a firm (Williamson, 1985), will have too much power to distribute CSR fund (Jensen, 2010) without being held accountable for the impact that the expenditure is creating toward social benefit, or worse still, use discretion over CSR to cement their respective position in the company with the help of stakeholder backing to the overall detriment of shareholder (Cespa & Cestone, 2007).

Will Mandatory CSR Increase Company Cost?

The aforesaid legislation is silent on cost of managing the responsibility of mandated CSR. Planning how to spend money well will need investment in appropriate people and processes, as well as in oversight; and companies may be loath to take on the challenge of this extra cost of time, effort, and resources. For example, trying to find out the needs of local community is a long and drawn-out endeavor, and "is inherently constrained by the companies' lack of developmental expertise and the technical/managerial approaches" dominantly adopted; thus it is highly likely that what passes as developmental needs are demands of locally influential persons (Frynas, 2005, p. 591). In an analysis of the management of charitable giving in large UK companies, it was found that there is considerable inertia in the processes by which the level of giving is determined (Brammer, Millington, & Pavelin, 2006).

Thus, companies may settle down for least cost options for spending the CSR fund by resorting to check-book philanthropy where one issues checks to various delivery partners to support sundry good causes. This low-cost emphasis on spending CSR fund is likely to create patronage-distributor tendencies in the company, toward various claimants for a share in the pie. Also, emphasis on spending would represent an end of process, rather than an ongoing engagement that can be "further developed and refined" (Waagstein, 2011, p. 462), leading to short-term expediency. This is more so as failure to spend the fund needs to be recorded in Annual Reports with public disclosure acting as implicit stress point. This can lead to a fragmented, defensive approach toward CSR, with focused intention on spending money.

CSR spend is expected to create private benefit to the business for its production of social benefits, say, in the form of increased customer and employee loyalty. However, if as argued above, CSR activities continue to be fragmented and oriented by top management's personal liking or by threat of dangerous stakeholder, then even the expected private benefit for the firm will be a casualty.

A company is neither equipped in extending social benefits nor can it be expected to maximize performance in more than one direction (e.g., profitability and societal impact). Attention to its primary goal of profit-generation may get deflected by making special attempts to put something back into society (Davis, 1973; Jensen, 2010). The company will be spending other people's money on other people; this may lead to profligacy (Friedman, 1970). Thus, resources may get poorly spent without any appropriate checks and balances, in the name of CSR. With every company trying to spend the money, there may be duplication of effort and wastage. Frynas (2005) shared an example of a road built parallel to another road built by the local development authority in Nigeria to highlight failure of planning and coordination, along with the absence of integration with macro-level development plan due to emphasis on short-term expediency which favors form more than substance. So, due to mCSR, companies may scale back voluntary initiatives, and the expected private benefit to the company may also be poorer.

Will mCSR Result in Competitive Disadvantage?

Companies which fall under the ambit of legislation may find it tougher to source money from the marketplace. As a portion of the profits, which could have been paid as dividend or retained for future expansion, has to be spent on CSR, prospective investors may decide to support smaller size businesses which do not fall under ambit of mCSR. Thus, mCSR is likely to create obstruction in free business.

Similarly, imposing legal obligations may limit voluntary initiatives, as well as place companies on the defensive and discourage them from embracing that responsibility. For example, environmental protection under mCSR will mean donation to environmental conservation issues or planting trees; however, it may preclude integrative CSR that aims at setting up an environmental management system at production facilities or innovative CSR that encourages firms to invest in development of innovative solutions like eco-efficient products or services (Halme & Laurila, 2009). In their decisional role (Mintzberg, 1990), managers are likely to practice opportunistic and self-serving behavior, as suggested above. For example, managing negative externalities of business leads to better financial performance for the firm compared to generating positive impact for nonmarket stakeholders (Lankoski, 2009). Thus, beyond mandated responsibility, business may just concentrate on managing negative externalities, rather than investing in products and processes to reduce creation of negative externalities. This may have long-term implication and mar competitiveness in the marketplace—for example, proactive launch of business models that provide the poor with affordable products or services that solve their problems may take a back seat, and thus companies may miss out market opportunities at the bottom of the pyramid. As all companies are not legally mandated to observe CSR norms in their operations, the regulation effectively discriminates against large companies, subjecting them to obligations from which smaller ones are exempt (Deva, 2004).

Amelioration of Problems and Implications

As a primary decision maker (Mintzberg, 1978), the CEO plays a critical role in social strategies and resource allocation to such pursuits (Agle, Mitchell, & Sonnenfeld, 1999; Wood, 1991). Upper echelons theory argues that executives strongly impact an organization's outcomes (Hambrick & Mason, 1984). Research has shown that there is "overwhelming importance of top management's values, ethics and morals in setting the tone of organisational culture" that acts as the foundation upon which CSR is built (Sirsly, 2009, p. 88), and that CEO discretion is the greatest influencer in corporate giving across institutional environments (Brammer et al., 2006). Thus, responsible spending of CSR funds can be linked to directions set by the upper echelon of the firm, tempered by their respective values, ethics, and morals.

The CSR fund, as per the legislation, is essentially money out of the pocket of shareholders, in the form of missed dividend. Hard data may not tell the whole story, and thus the Board may need to spend judicious time in finding out how the CSR policy is being implemented. However, there are no universally accepted criteria to collect, assess, and compare the output. For example, a firm, using its available CSR fund, achieves 100 percent literacy rate in its immediate community. The amount of resources spent to achieve this result cannot be compared, or commented upon within any generally accepted or notified standards. So, questions around appropriate utilization of resources remain open to debate. Codification and certification of practices that lead to societal benefit, and allow comparison of net benefit across diverse settings, and "makes visible whether a firm indeed does things in the way they should be done" (Terlack, 2007, p. 972) may actually help both the shareholders as well as civil society to oversee the appropriate social benefit against resources used "by achieving transparency, communication, and accountability" (Waddock, 2000, p. 343).

Conclusion

The expectations from business have undergone drastic changes in recent years. In countries like the United Kingdom, Italy, and Norway, it is accepted that business has a role to play in sustaining the modern welfare state, though this comes fore in different ways (Albareda et al., 2008). The role has been to promote and encourage CSR, as well as "mediate in and catalyze perceptions and expectations … to encourage and lead multi-stakeholder dialogues and partnership projects" (*ibid*, p. 360). Examples of such soft legislation and practices are not deemed enough by proponents arguing for stricter regulation, and mCSR seems to be the way ahead. However, charities, NGOs, and civil society groups may yet not celebrate as there now seems to be too much managerial discretion available in spending CSR funds, without commensurate mechanism of oversight.

In reference to Indian legislature, as a business starts providing welfare state services, the boundary between role of government and business gets blurred. We argue that the Board's very close attention to the creation of appropriate CSR policy, and oversight regarding its implementation will be buoyed by right "upper echelon" at the top, and by rigorous vigil by civil societies with an appropriate, generally accepted measurement system of societal impact. The battle of getting capitalist business to spend for the good of society has been won, but the war to make an impact in the society through this means is yet to begin. After all, as pointed out by Leisinger (2007, p. 331) the challenge of corporate philanthropy—whether motivation comes from heart or through a mandate—is that "the outcomes (or impact) must be achieved in the most efficient, cost-effective and significant way".

References

Agle, B. R., Mitchell, R. K., & Sonnenfeld, J. A. (1999). Who matters to CEOs? An investigation of stakeholder attributes and salience, company performance and CEO values. *The Academy of Management Journal, 42*(5), 507–525.

Albareda, L., Lozano, J. M., Tencati, A., Midttun, A., & Perrini, F. (2008). The changing role of governments in corporate social responsibility: Drivers and responses. *Business Ethics: A European Review, 17*(4), 347–363.

Albareda, L., Tencati, A., Lozano, J. M., & Perrini, F. (2006). The government's role in promoting corporate responsibility: A comparative analysis of Italy and UK from the relational state perspective. *Corporate Governance: The International Journal of Business in Society, 6*(4), 386–400.

Balasubramanian, N. K., Kimber, D., & Siemensma, F. (2005). Emerging opportunities or traditions reinforced? An analysis of the attitudes towards CSR and trends of thinking about CSR in India. *The Journal of Corporate Citizenship, 17*(Spring), 79–92.

Barnea, A., & Rubin, A. (2010). Corporate social responsibility as a conflict between shareholders. *Journal of Business Ethics, 97*(1), 71–86.

Baxi, U. (2005). Market fundamentalisms: Business ethics at the altar of human rights. *Human Rights Law Review, 5*(1), 1–26.

Brammer, S., Millington, A., & Pavelin, S. (2006). Is philanthropy strategic? An analysis of the management of charitable giving in large UK companies. *Business Ethics: A European Review, 15*(3), 234–245.

Carroll, A. B. (1979). A three-dimensional conceptual model of corporate performance. *The Academy of Management Review, 4*(4), 497–505.

Carroll, A. B. (1999). Corporate social responsibility: Evolution of a definitional construct. *Business & Society, 38*(3), 268–295.

Carroll, A. B., & Buchholtz, A. K. (2006). *Business and society: Ethics and shareholder management* (6th ed.). Mason, OH: Thomson, South Western.

Cespa, G., & Cestone, G. (2007). Company social responsibility and managerial entrenchment. *Journal of Economics and Management Strategy, 16*(3), 741–771.

Chatterjee, S. R., & Pearson, C. A. L. (2000). Indian managers in transition: Orientation, work Goals, values and ethics. *Management International Review, 40*(1), 81–95.

Croquet, N., Hameed, A. & Yalkin, T. R. (2009). Corporate social responsibility in the European Union. http://www.reports-and-materials.org/CSR-soft-law-in-EU-Oxford-Pro-Bono-Publico-for-Ruggie-30-Jul-2009.pdf. Accessed 14 Apr 2014.

Davis, K. (1973). The case for and against business assumption of social responsibilities. *The Academy of Management Journal, 16*(2), 312–322.

Deva, S. (2004). Acting extraterritorial to tame multinational corporations for human rights violations: Who should 'bell the cat'? *Melbourne Journal of International Law, 5*(1), 52–54.

Donaldson, T., & Preston, L. E. (1995). The stakeholder theory of the corporation: Concepts, evidence and implications. *The Academy of Management Review, 20*(1), 65–91.

Eisenhardt, K. M. (1989). Agency theory: An assessment and review. *The Academy of Management Review, 14*(1), 57–74.

Fooks, G., Gilmore, A., Collin, J., Holden, C., & Lee, K. (2013). The limits of company social responsibility: Techniques of neutralization, stakeholder management and political CSR. *The Journal of Business Ethics, 112*(2), 283–299.

Fox, T., Ward, H., & Howard, B. (2002, October). *Public sector roles in strengthening corporate social responsibility: A baseline study*. Washington, DC: World Bank group.

Freeman, R. E. (1984). *Strategic management: A stakeholder approach*. Marshfield, MA: Pitman.

Friedman, M. (1970, September 13). The social responsibility of business is to increase its profits. *The New York Times*.

Frynas, J. G. (2005). The false developmental promise of corporate social responsibility: Evidence from multinational oil companies. *International Affairs, 81*(3), 581–598.

Gandhi, M. K. (1939). http://www.mkgandhi.org/ebks/trusteeship.pdf. Accessed 28 Feb 2014.

Garriga, E., & Mele, D. (2004). Corporate social responsibility theories: Mapping the territory. *Journal of Business Ethics, 53*(1–2), 51–71.

Gautam, R., & Singh, A. (2010). Corporate social responsibility practices in India: A study of top 500 companies. *Global Business and Management Research: An International Journal, 2*(1), 41–56.

Gopinath, C. (2005). Trusteeship as a moral foundation of business. *Business and Society Review, 110*(3), 331–344.

Gugler, P., & Shi, J. Y. J. (2008). Corporate social responsibility for developing country multinational corporations: Lost war in pertaining global competitiveness? *Journal of Business Ethics, 87*(Supplement 1), 3–24.

Halme, M., & Laurila, J. (2009). Philanthropy, integration or innovation? Exploring the financial and societal outcomes of different types of corporate responsibility. *Journal of Business Ethics, 84*(3), 325–339.

Hambrick, D. C., & Mason, P. A. (1984). Upper echelons: The organization as a reflection of its top managers. *The Academy of Management Review, 9*(2), 193–206.

Hemingway, C. A., & Maclagan, P. W. (2004). Manager's personal values as drivers of company social responsibility. *Journal of Business Ethics, 50*(1), 33–44.

Idemudia, U. (2011). Corporate social responsibility and developing countries moving the critical CSR research agenda in Africa forward. *Progress in Development Studies, 11*(1), 1–18.

Jamali, D., & Neville, B. (2011). Convergence versus divergence of CSR in developing countries: An embedded multi-layered institutional lens. *Journal of Business Ethics, 102*(4), 599–621.

Jensen, M. C. (2010). Value maximization, stakeholder theory and the company objective function. *Journal of Applied Company Finance, 22*(1), 32–42.

Joseph, E. (2001). Corporate social responsibility: Delivering the new agenda. *New Economy, 8*(2), 121–123.

Kakabadse, A. P., Kakabadse, N. K., & Rozuel, C. (2007). Corporate social responsibility: Contrast of meanings and intents. In A. P. Kakabadse & N. K. Kakabadse (Eds.), *CSR in practice: Delving deep* (pp. 9–44). London: Palgrave.

Lankoski, L. (2009). Differential economic impacts of corporate responsibility issues. *Business & Society, 48*(2), 206–224.

Leisinger, K. M. (2007). Corporate philanthropy: The "top of the pyramid". *Business and Society Review, 112*(3), 315–342.
Lund-Thomsen, P. (2004). Towards a critical framework on corporate social and environmental responsibility in the south: The case of Pakistan. *Development, 47*(3), 106–113.
Matten, D., & Moon, J. (2008). "Implicit" and "explicit" CSR: A conceptual framework for a comparative understanding of corporate social responsibility. *Academy of Management Review, 33*(2), 404–424.
Mintzberg, H. (1978). Patterns in strategy formation. *Management Science, 24*(9), 934–948.
Mintzberg, H. (1990, March–April). The manager's job: Folklore and fact. *Harvard Business Review*.
Mitchell, R. K., Agle, B. R., & Wood, D. J. (1997). Toward a theory of stakeholder identification and salience: Defining the principle of who and what really counts. *The Academy of Management Review, 22*(4), 853–886.
Moon, J. (2004). Government as a driver of company social responsibility: The UK in comparative perspective. *ICCSR Research Paper Series*, 20(2004), ICCSR, University of Nottingham, 1–27.
Shankar, R., Chadwick, L., Ghafoor, S., & Khan, U. F. (2011). Development of corporate social responsibility (CSR) in India. *Journal of Asian Scientific Research, 1*(3), 87–101.
Sirsly, C. T. (2009). 75 years of lessons learned: Chief executive officer values and company social responsibility. *Journal of Management History, 15*(1), 78–94.
Snider, J., Hill, R. P., & Martin, D. (2003). Corporate social responsibility in the 21st century: A view from the world's most successful firms. *Journal of Business Ethics, 48*(2), 175–187.
Terlack, A. (2007). Order without law? The role of certified management standards in shaping socially desired firm behaviors. *The Academy of Management Review, 32*(3), 968–985.
UNDESA. (2007). CSR and developing countries: What scope for government action? *In Innovation briefs*. United Nations Department of Economic and Social Affairs, Division for Sustainable Development, 1, 1–8. or UNDESA. (2007, February). CSR and developing countries: What scope for government action? *Sustainable Development Innovation Briefs*, 1–8.
Valor, C. (2005). Corporate social responsibility and company citizenship: Towards company accountability. *Business and Society Review, 110*(2), 191–212.

Visser, W. (2008). Corporate social responsibility in developing countries. In A. Crane, A. McWilliams, D. Matten, J. Moon, & D. Siegel (Eds.), *The Oxford handbook of corporate social responsibility* (pp. 473–503). Oxford: Oxford University Press.

Waagstein, P. R. (2011). The mandatory company social responsibility in Indonesia: Problems and implications. *Journal of Business Ethics, 98*(3), 455–466.

Waddock, S. (2000). The multiple bottom lines of company citizenship: Social investing, reputation and responsibility audits. *Business and Society Review, 105*(3), 323–345.

Williamson, O. E. (1985). *The economic institutions of capitalism*. New York: Free Press.

Wood, D. J. (1991). Corporate social performance revisited. *The Academy of Management Review, 16*(4), 691–718.

Zadek, S. (2002). *Third generation company citizenship*. London: Foreign Policy Centre and AccountAbility.

Zile, V. C. (2012). India's mandatory corporate social responsibility proposal: Creative capitalism meets creative regulation in the global market. *Asian-Pacific Law & Policy Journal, 13*(2), 269–303.

20

Connecting the Base of the Pyramid to Global Markets Through E-commerce: A Case Study of BAIF (India)

Raji Ajwani-Ramchandani

Introduction

The base of the pyramid (BOP) concept (Hammond & Prahalad, 2004) is premised on the notion that there is profit to be made by "doing good". Prahalad and Hammond (2002) made a strong case for considering human development not as a humanitarian cause but as an attractive and profitable proposition for multinationals and large corporations, outlining ways in which private enterprises, governments, nongovernmental

Source: Department of Industrial Policy & Promotion, Government of India (www.dipp.nic.in). The term "e-commerce" is used to describe the sale or purchase of goods and services conducted over network of computers or TV channels by methods specifically designed for the purpose. Even though goods and services are ordered electronically, payments or delivery of goods and services need not be conducted online. E-commerce transactions can be between businesses, households, individuals, governments, and other public or private organizations. There are numerous types of e-commerce transactions that occur online, ranging from sale of clothes, shoes, books, and so on to services such as airline tickets or making hotel bookings.

R. Ajwani-Ramchandani (✉)
Independent researcher, Pune, India
e-mail: raji.ajwani@gmail.com

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1_20

organizations (NGOs), and the poor could work in a collaborative manner. According to Prahalad and Hammond (2002), the way forward was to conceptualize and "co-create" solutions and entrepreneurship involving the BOP. They advocated increased use of technology among BOP consumers and stated that designing and developing products and transparent sales interfaces with the BOP in mind could help to curb corruption and facilitate commercial transactions. BOP markets are often rural and poorly served, as well as relatively inefficient and uncompetitive. Developing nations have also assumed a place of importance in the last two decades. Substantial shifts in business practices have been spurred due to technology, and especially the Internet, which has essentially helped to create virtual marketplaces that can transcend national boundaries.

Mudambi (2015) discussed three megatrends defining contemporary international business: (1) the shift from trade-in-goods to trade-in-activities, (2) a rise in knowledge-intensive intangibles, and (3) a rise of emerging markets due to the dispersion of the global value chain activities across these geographies, which has resulted in a "flatness" in the geography of innovation. Clusters in Asia, South America, and Africa have become integral parts of the global value chain activities of large MNEs.

This discussion assumes relevance in the light of the funds being invested, and the revenues earned, by MNEs in developing countries such as India and China. For example, India is the fastest growing market, worldwide, for the US-based e-commerce company Amazon, which had about 25 million products for sale in the country during 2015 (Fortune, 2015). About 40 % of the Dutch multinational Unilever's Indian arm (Hindustan Unilever) business is sourced from the rural Indian hinterlands (Hindustan Unilever Limited, 2012). The Chinese online retailer Alibaba was listed on the New York Stock Exchange at a valuation of US$231 billion. The main driver propelling its popularity is the linkage established by Alibaba with small traders and businesses catering to the domestic Chinese clientele through its online platform, TaoBao. A key factor contributing to TaoBao's popularity is its connection with Chinese consumers' buying and shopping preferences and patterns.

According to the BoP Protocol (Simanis, Hart, & Duke, 2008), partnerships with NGOs can help MNEs to obtain a better understanding of local conditions. Webb, Kistruck, Ireland, and Ketchen (2010) argued that MNEs can use their partnerships with NGOs to overcome institutional barriers that they may encounter as they seek to grow their business from one market to another. Many NGOs are in the position of being familiar with the institutional environments of both the developed economy and the BOP markets, which enable them to act as valuable aides in complementing the MNEs' processes and knowledge bases. Such a symbiotic arrangement can help to overcome some of the deterrents to the economic empowerment of the BOP, such as fragmented and opaque markets that are often poorly served and are often inefficient and uncompetitive, thereby fostering a vicious cycle of exploitation, inequality, and poverty.

In this chapter, we try to illustrate the issues faced by an NGO that is trying to link the BOP with "glo-cal" markets via the e-commerce route; in order to better place the issues in perspective, we illustrate this through the case study of one of India's biggest NGOs—BAIF. By "glo-cal", we mean a situation wherein a seller is able to use the e-commerce platform, typically in a developing-nation market (such as India or China), to sell directly in the local market and also indirectly to foreign buyers. This is possible due to various reasons. First, the products can be viewed and purchased by a proxy buyer in the local market, using the local currency, and then shipped to an overseas destination where the actual user/payer of the product resides. Second, the overseas buyer, residing in a developed economy, is able to take advantage of exchange rate arbitrage by purchasing from a developing-economy marketplace. Third, the foreign-domiciled purchaser is able to access foreign markets directly.[1] Since the boom in the Indian e-commerce sector is a relatively recent phenomenon, this chapter adds to the literature on this subject. We postulate that, while NGOs have unique skills and experience in working with at grassroots level, they are also very well connected to the issues and problems prevailing at the BOP level and can, therefore, be the "bridge" for obtaining useful insights and data that can help MNEs to enhance or customize their portfolios. Consequently, large corporations and MNEs will benefit from

[1] In June 2015, Amazon India extended two of its products to sellers in India. Selling on Amazon (SOA) and fulfillment by Amazon (FBA) will enable various manufacturers across categories such as apparel, home furnishings, jewelry, and handicrafts to access the U.S. and U.K. markets (Vikas, 2015).

recognizing the "vital linkage" and try to adopt an inclusive approach that can result in both economic and social benefits (Webb et al., 2010).

The chapter is structured as follows. The next section provides a brief review of literature, including some points and counterpoints regarding BOP-related theoretical perspectives. The following section provides an insight into BAIF, a Pune-based NGO, and its activities. This section also discusses the challenges faced by BAIF in trying to market the products made and sourced from tribal producers via the e-commerce site Snapdeal.com. The ensuing section addresses the future of the glo-cal marketplace, in the light of e-commerce developments. This is followed by the presentation of a theoretical model, derived based on the case study, and the final section provides conclusions.

Review of the Literature

The rationale for focusing on developing markets has been documented and established The saturation of existing developed markets in some businesses and the vulnerability associated with business cycles have resulted in a focus on new ways to create value (Seelos & Mair, 2005). Traditional measures such as restructuring and cost-cutting have a short-term impact and may hamper innovation. Luo and Tung (2007) proposed a springboard investment perspective, according to which developing-market multinationals leverage international expansion opportunities as a way to overcome problems in their local (home) markets.

Raynor (2003) recommended that businesses should look beyond their existing core markets and customers, and instead consider simple disruptions that can help to develop new approaches to price and quality, so as to develop new clients. Hammond (2007) differentiated between the market-based approach to poverty reduction, vis-à-vis the more traditional approach, which aims at addressing basic needs of the poor through subsidies and dole-outs, but does not produce striking results. A market-based approach, on the other hand, recognizes that it is not just the poor who have unmet needs. Rather, it considers willingness to pay across market segments. Solutions are then developed by designing new business models and products.

Abramovitz (1986) argued that it is the inability of the poor to create or respond to economic opportunities that results in sustained poverty. The World Business Council for Sustainable Development has advocated the development of a stable market economy that emphasizes collaboration, innovation, eco-efficiency, informed consumer choice, improved market framework conditions, and making the market work for everyone (WBCSD, 2001).

The rapid growth of the e-commerce sector in India has managed to overcome some barriers associated in linking businesses with clients. In fact, the growth, both in the numbers and in the features of the e-commerce retailing models (e.g., Snapdeal, Flipkart, and Jabong, to name a few), has been extraordinary, compared to even the phenomenal Chinese success; as Hu (2004) noted, Alibaba was operating at a loss until 2004. The Indian e-commerce retailing space has managed to scale the model to suit a diverse set of clients and markets. The main feature of e-commerce is its ability to transcend physical boundaries and reach customers in a manner different from the traditional brick-and-mortar stores, at their very doorstep. Efficient logistics and infrastructure are the backbone, and many investment opportunities exist in this sector because these are the weak links, at present, in the Indian context (ASSOCHAM, 2014).

This sector has attracted considerable activity and funding, as investors have put money into companies that are selling a variety of products to clients across India. With close to 250 million Internet users, the Indian e-commerce industry represents an interesting opportunity for foreign institutional investors. For example, in 2015, Flipkart and Snapdeal received US$750 million and US$500 million, respectively. The e-commerce delivery and logistics management company E-Com Express received US$133 million, while the Grofers (an online grocery) portal received US$165 million.[2,3,4]

[2] Source: https://www.techinasia.com/asia-biggest-funding-rounds-2015, accessed on April 8 2016.

[3] The main investors during 2015 in the above-mentioned e-commerce companies were as follows: Flipkart (Morgan Stanley, Vulcan Capital, Naspers, Qatar Investment Authority, and T. Rowe Price), Snapdeal (Soft Bank, Black Rock, EBay, Intel Capital, Alibaba, and Fox Conn), E-Com Express (Warburg Pincus).

[4] Source: https://e27.co/softbank-backed-grofers-shuts-operations-9-cities-due-poor-uptake-20160105/, accessed on April 8, 2016.

Given the challenges of operating in a demanding scenario, particularly that prevailing in developing nations, the inputs from, and the symbiotic arrangements with community associations and NGOs, can prove very useful in helping businesses in accessing resources that, in turn, can influence profit-related outcomes. Successful community-based organizations are thus able to build and blend resources and capabilities, to achieve social as well as economic objectives. Rich (1980) noted the triple roles performed by such institutions, *viz.*: (1) consumer cooperatives, (2) alternative producers of desired services, and (3) organizers of citizen's cooperative efforts.

An Overview of BAIF: An NGO Providing Integrated Livelihood Solutions to the Poor

The Context

BAIF is a voluntary organization headquartered in Pune, currently working with over 4.5 million poor families, across 60,000 villages spread over 16 states of India, through their 4500 employees. BAIF has won several awards, including the 2005 India Innovation Award, the 2008 India NGO Award, and the Vasantrao Naik Jala Samvardhan Award in 2005.[5] The NGO's main activities are in the areas of sustainable agriculture, horticulture, dairy and goat husbandry, water resources development, and various rural non-farm activities for generating employment for landless families. They work with *adivasis*,[6] who are small and marginal farmers. According

[5] Source: http://www.baif.org.in/about_us_awards_and_achievements.asp, accessed on April 8, 2016.

[6] The word *adivasis* means "indigenous people" or "original inhabitants", though the term "Scheduled Tribes" (STs) is not coterminous with *adivasis*. ST is an administrative term used for purposes of "administering" certain constitutional privileges, protection, and benefits for specific sections of peoples considered historically disadvantaged and "backward". For practical purposes, the United Nations and multilateral agencies generally consider the STs as "indigenous peoples". Over the centuries, the *adivasis* have evolved an intricate convivial-custodial mode of living in harmony with their land. *Adivasis* belong to their territories, which are the essence of their existence. They were, in effect, the self-governing "first nations" of India, in pre-historic times. In general, and in most parts of the pre-colonial period, they were notionally part of the "unknown frontier", and lived a life outside the purview of traditional rulers. The system of conferring large

to the 2011 Indian census, there are 461 groups classified as "scheduled tribes" by the Government of India. There are approximately 1.21 billion *adivasis* in India, concentrated in the geographical belt that stretches across Rajasthan, Gujarat, West Bengal, Odissa, and parts of northeast India. These households traditionally derive sustenance through forestry, hunting, and primitive agriculture practices. Seasonal migration to nearby cities has become a virtual necessity, due to rapidly depleting forest and natural resources, land erosion, and a lack of access to basic health and hygiene. *Adivasis* typically practice rain-fed agriculture, and the small and marginal nature of their land holdings often leaves them in a vulnerable position with regard to their food security, resulting in forced migration, exploitation at the hand of human touts, and in extreme cases, starvation and death. Once in the cities, these "landless" workers almost always live in deplorable conditions, and are subject to exploitation by middlemen. Ineffective labor laws make their situation very difficult, especially for women.

Published literature in this area has emphasized the need to connect small and marginal farmers to remunerative markets, to help the farmers to realize better returns (e.g., Ashley, Start, Slater, & Deshingkar, 2003; Dorward, Kydd, Morrison, & Urey, 2004). Lack of capital and purchasing power affects the scale of operations, while the lack of market linkages hampers the seed-to-market journey; often, as a result, the input costs are far greater than the output. BAIF has pioneered the "*wadi*" model, which enables small and marginal farmers to develop sustainable livelihoods by aggregating their landholdings.

What Is the *Wadi* Model?

The word "*wadi*" ("fruit orchard"), which has its origins in the Gujurati language, and represents a small orchard, covering one acre with crops such as cashews, mangos, or any suitable fruit, with forestry species on the periphery and a border consisting of a productive live hedge; see Fig. 20.1. A typical orchard promoted under this scheme involves planting 40–60 fruit plants and 300–400 forestry species along the border.

---

parcels of land as "*zamindaris*", or rewards, started by the British, further pushed this section of people toward the periphery of social inclusion and accorded them a social status or caste that was low in the hierarchy of importance.

#	#	#	#	#	#	#	#	#	#	#	#	#	#	#	#
#	*	*	*	*	*	*	*	*	*	*	*	*	*	*	#
#	*	M	M	M	M	C	C	C	C	C	C	C	C	*	#
#	*	M	M	M	M	C	C	C	C	C	C	C	C	*	#
#	*	M	M	M	M	C	C	C	C	C	C	C	C	*	#
#	*	M	M	M	M	C	C	C	C	C	C	C	C	*	#
#	*	M	M	M	M	C	C	C	C	C	C	C	C	*	#
#	*	*	*	*	*	*	*	*	*	*	*	*	*	*	#
#	#	#	#	#	#	#	#	#	#	#	#	#	#	#	#

= Fencing, *= Forestry, M = Mango, C = Cashew
Composition: 20 Mango, 40 Cashew, 400 Forestry
Adapted from BAIF-Pune

Fig. 20.1 *Wadi* layout (1 acre) (# Fencing, * Forestry, *M* Mango, *C* Cashew; Composition: 20 Mango, 40 Cashew, 400 Forestry; Adapted from BAIF-Pune)

The Rationale

Dr. Manibhai Desai, the founder of BAIF, believed in the Gandhian philosophy of revitalizing the village economy. The Vansda region in Gujarat, where this project was initiated, is representative of many of the problems affecting most tribal communities. People practiced rain-fed agriculture, and hence cultivation was only possible during *kharif*[7] (summer) season. Production was poor, due to a lack of improved cultivation practices. After the *kharif* harvest, families had no option but to migrate to adjacent cities in search of livelihood. Migration was characterized by exploitation and the discontinuation of children's education, while a lack of healthcare options, weak communication, and poor housing and sanitation added to the problems.

After evaluation of various alternatives, it was decided to focus on cultivating mangoes and cashews. Some of the factors that made these two crops the preferred choices were agro-climatic suitability, robust demand, good shelf life, and the possibilities available for processing mangoes into various by-products such as pulp, pickles, juices, jam, canned fruit, and baby food, as well as good local and international markets for cashews.

[7] The two crop seasons in India are "*kharif*" (summer) and "*rabi*" (winter).The *kharif* sowing season starts around June/July (monsoon) and harvesting is around September/October; typical crops are rice, maize, and groundnuts. The *rabi* sowing starts around October/November and harvesting is done in March/April; crops include wheat, gram (chickpeas), and barley.

Only 42 tribal families participated in the endeavor when it was launched in 1982. BAIF played the role of facilitator, trainer, and guide in helping the community to accept the long and challenging task of preparing the groundwork required to succeed, since the trees started bearing fruit only after four or five years. In areas where irrigation options were not available, participating tribal members would carry water in pots atop their heads for hours, to water and tend the saplings; this had to be done daily for nearly four years before the fruit plants stabilized. The participating tribal families earned in the range of about INR 8000–10,000 (approximately US$160–200) per annum from the intercrops (cereals, rice, pulses, and some vegetables such as eggplants (*brinjals*) and tomatoes) for the first years. The enhanced income of approximately INR 30,000–40,000 per annum (US$600–820) came after six or seven years, when the orchards started to bear fruit on a regular basis.

The BAIF–Snapdeal.com Tie-Up: Foray into the E-commerce Space

BAIF had been selling their products mainly from their headquarters in the city of Pune, and a second location in Uruli Kanchan (Pune district). However, advertising was negligible, which limited reach. The tie-up with the e-commerce company Snapdeal.com commenced in October 2014. Some of the perceived advantages of this tie-up were as follows.

Expanded Customer Outreach Plugging into the e-commerce market would enable BAIF to connect directly with customers across India, and indirectly with international buyers, without actually investing into physical infrastructure or implementing a franchise-based model. The availability of information, such as a brief description, price, size, quantity, and so on, about various products displayed on the e-commerce portal offered the potential to facilitate indirect international sales, where a foreign individual buyer purchases the product through an Indian intermediary (e.g., relatives or friends) and then has it shipped to the foreign destination. BAIF hoped to get bulk orders from foreign buyers as well as overseas Indians, who could thus contribute toward a good cause by patronizing the product offerings.

Higher Returns Direct access to the market and part of the value chain was facilitated by Snapdeal, without involving any middlemen.

Using Sustainable Methods of Production for Creating Livelihoods This is the result of using organic farming techniques and indigenous resources and methods. One example pertains to the material used to weave silk sarees, created by tribal people in underdeveloped areas of Gadhchiroli (Maharashtra). Local people were engaged in sericulture (silk farming) activities, so as to generate sustainable employment while capitalizing on the rich flora available in the vicinity. Leaves of the locally abundant *Termanalia tomentosa* (mulberry) plant were used for rearing silkworms. Engaging local tribal people in such livelihood-generating activities generated income and had other benefits, such as helping to keep negative activities at bay, especially since that particular area falls in a part of the country prone to terrorist (Naxal) activities.

BAIF identified a variety of products identified for sale via the internet. Organically grown produce was sourced from Valsad (South Gujarat), Nashik (Maharashtra), and Udaipur (Rajasthan). Pickles, jams, spreads, and juice concentrates were the main items prepared from the organic produce, and due care was taken to ensure that the facility met the necessary regulatory requirements. Moreover, the preservatives used were tested and approved by a food technologist. The edible items were introduced under the “gourmet foods” category on Snapdeal.com. In addition, BAIF introduced silk sarees on the web portal.

However, after three months of listing the items on Snapdeal.com, only seven units of the processed gourmet foods and one saree had been sold. BAIF stopped selling on Snapdeal and on other e-commerce sites after six months.

Challenges Encountered by the NGO Following the Snapdeal (E-commerce) Tie-up

Although the tie-up with Snapdeal had seemed like an attractive option, in reality it did not work out for BAIF. Some of the reasons for this are discussed below.

High Marketing Costs The steep costs associated with listing products on Snapdeal dented BAIFs revenues; the main costs were the portal hosting/ marketing fee, fixed commission, logistics cost, and payment collection charges. Discounts offered to customers, in order to make the product price-competitive, were deducted from the selling price. Moreover, profit margins were thin, since the products were manufactured using organic methods and the workers were paid fair wages.

Lack of Skilled Digital Marketing Resources at the Promoting NGO (BAIF) The main strength of BAIF was/is in working at the field level with people (beneficiaries). Marketing concepts, especially keeping in mind the online customer, were alien to them. They did not have the skilled human resources in-house or the funds to hire the talent required to position their brand in the e-commerce space. Their website was a static one, which did not enable any sales transactions. Labeling was brief, and did not highlight the tremendous backend efforts involved in bringing the products from the farm to the fork. Packaging was minimal, and the product description on the e-commerce portal did not provide the requisite information regarding the products' unique sales proposition. In fact, the most popular e-commerce websites do not offer a separate space for products sourced through organizations that promote sustainable agri-livelihood practices, as opposed to "regular products", which are generally lower priced. Hence, unless the customer is internet savvy or makes a special effort to locate such products, or is already familiar with the brand, these sustainable products risk losing out to their mainstream rivals

Vulnerability to Negative Feedback via the Digital Medium It takes just a few clicks for negative feedback to travel through the digital space, and BAIF was rattled when it received its first sale rejection and negative feedback. In addition to the fact that online retailers usually have a fairly steep fee for returning the rejected item back to the seller, BAIF was not used to handling such situations, and accordingly found it difficult to articulate their responses.

Price Disadvantage Competing in a crowded market, the issue of price point was difficult for BAIF, since their organically grown products were expensive, relative to competing options. The high cost of maintaining an online presence was also an issue, and they eventually decided to withdraw their listing from the e-commerce portal.

BAIF made efforts to overcome these challenges. The NGO tried deploying business school interns on a part time basis; however, the students' busy campus schedules, along with the logistics involved in commuting to BAIF's office, made it difficult to sustain the arrangement. BAIF struggled to recruit interns for longer assignments (e.g., three-month summer internships), due to the substantially lower stipend, relative to those offered by MNEs and leading Indian companies. It became evident that, in order to generate a visible difference in e-commerce sales, a proper marketing department, adequately staffed with skilled personnel, would be required. The NGO decided to revert to its earlier model of direct sales, via kiosks near its main office building in Warje and by approaching corporates, housing apartment complexes, and so on. In the meantime, BAIF is continuing to examine ways in which they may be able to jump on to the e-commerce bandwagon that would enable them to connect the producers with the global marketplace.

The Future of the Glo-Cal Marketplace and the BOP

In the past, BAIF had engaged with large corporate partners such as ITC, an Indian fast-moving consumer goods (FMCG) company. Under this arrangement, ITC took care of the marketing and sourced the agri-produce from BAIF. ITC's main motivations for procuring from BAIF were the ability to source organically grown produce and to contribute toward improving the livelihoods of marginal farmers. This partnership formed a part of ITC's CSR initiative; this allowed access to some government-promoted schemes, which enhanced the efficacy of the public-private partnership. The presence of three "vital linkages"—government, industry, and people's organizations—were viewed as instrumental in creating positive results. Combining the specific strengths and expertise of each of the parties resulted in synergy that yielded a win-win-win situation.

This synergistic balance was missing in the BAIF–Snapdeal e-commerce deal, since the NGO was unable to cope with the costs involved in getting its products listed for sale or securing adequate sales of its goods that were sourced in a sustainable manner from the poor and marginal tribal farmers. Ou and Davison (2009) cited TaoBao's glo-cal perspective as a key reason for its managing to edge out a giant such as eBay from the Chinese e-commerce market. TaoBao (operated by Alibaba) adapted to local preferences by customizing its interface that was able to fulfill the requirements of potential customers. For example, TaoBao's instant messaging mechanism, WangWang, was developed specifically for the Chinese context, in contrast to eBay (China), whose website had more of an international look and feel to it; effectively, the international eBay model had been adopted, with minor modifications, for the Chinese market. Another important aspect was the free-of-charge model that enabled customer-to-customer (C2C) connections. This close connect with the Chinese marketplace was a key reason for Alibaba's global appeal for foreign investors that wanted to be part of the Chinese e-retail market that is expected to reach US$1 trillion by 2018 (Forbes, 2015), exceeding the combined e-commerce markets in Europe, the USA, and Japan.

The BAIF–Snapdeal experiment reflects the possibility of creating a new market scenario, or a potential "blue ocean" (Kim & Mauborgne 2005), by leveraging the surge in e-commerce. BAIF can enjoy a unique sweet spot that is uncontested, due to its rich experience and impeccable track record, scale of operations, geographical spread, access to R&D, and linkages with various stakeholders such as the government and donors.

For organizations like BAIF, gaining access to e-commerce through a portal such as Snapdeal represents a first step toward gaining indirect access to foreign markets, while presenting an opportunity to fine-tune its product offerings and differentiate itself via branding and packaging. An e-commerce platform such as Snapdeal can assist MNEs in locating and partnering with grassroots organizations like BAIF, for sourcing existing products or entering into an alliance for custom-creating new products or ingredients that can be used in international supply chains. BAIF's presence across 16 states of India gives it a huge basis from which to provide a wide range of product offerings, including organically grown flowers, teas, mangoes, and cashews, along with indigenously created *warli* paintings and silk items. This approach offers the potential for integration of the BOP by MNEs, as producers, suppliers, and business partners, which can help disadvantaged people to move out of their difficult situations. The result can be initiatives that help to provide the marginalized with a ladder out of poverty, in a sustainable manner, via a "virtual meeting spot". The dynamics of such a future market place, and the intermeshing of glo-cal stakeholders, is explained below in a theoretical model.

Theoretical Model

The model shows the connection between the developed and the developing countries, with respect to goods and services offered by the MNEs. NGOs such as BAIF can form the bridge that can help MNEs to engage with markets in the developing nations for several reasons. First, NGOs are able to help transcend the often-poor levels of social and infrastructure development that often exist in such markets. This is possible by virtue of the vintage, experience, and proven track records of NGOs such as BAIF in terms of transforming lives at the grassroots level. This provides the potential for MNEs to obtain data that allow them to customize their products to suit the needs of such markets. Second, this input can also result in product innovations that are aimed specifically to suit such markets (Prahalad & Ramaswamy, 2004) and the application of such innovations in other markets as well. Third, the NGOs can help in dealing with problematic governance conditions that often exist in such markets (Cuervo-Cazurra & Genc, 2008). Having access to such context-specific and deep knowledge can help MNEs to avoid costly mistakes, and facilitate insights that can otherwise be very difficult to obtain, in light of the complexities involved in reaching such a segment (e.g., poor infrastructure, language and social barriers, and inhibitions with respect to engaging with unfamiliar entities).It is reasonable to expect that the global market place will become more "compact" in the future, as a result of internet-enabled information flows. MNEs are likely to find themselves operating in an environment that is influenced by four key set of stakeholders: customers, competitors, creators of statutory norms, and consumer activists. In this future, demand-related changes may be shaped by proactive customers, equipped by enhanced information flows While the developed nations are likely to remain the hub of R&D and innovation (e.g., Mudambi, 2008), there is no reason to assume that developing nations will lose their attractiveness, due to low-cost manufacturing and the attendant potential for the development of mass customization, along with large potential sales volumes associated with increased disposable incomes and a growing middle class. MNEs already fine-slice their location choices (Buckley & Ghauri, 2004), depending upon various factors such as type of industry, replication possibilities, business policies and regulations prevailing in host nation, and business models.

The e-commerce route offers an option for MNEs to connect with the mass of potential customers at the BOP in developing nations such as India. However, in order to develop into a sustainable customer base, the BOP needs to be integrated into the cycle of prosperity (Karnani, 2005), not only as clients but also as suppliers and partners. An inclusive model can help to upgrade the BOP such that people are able to "move up", due to enhanced livelihood opportunities and income, which can result in their becoming potential customers for the goods and services being provided by MNEs, especially those manufacturers and service providers that are able to link BOP offerings with potential markets An NGO–MNE linkage can also help to bypass the inefficiencies that are generally inherent in rural BOP markets such as those in India; the influential presence of middlemen and brokers, archaic laws, and a sluggish enforcement mechanism, coupled with an element of politics, too often prevents small and marginal farmers, artisans, and independent operators from participating on a level playing field. Such linkages, combined with e-commerce, have the ability to bypass such bottlenecks, and help to overcome the shortfalls that are inherent in developing-nation rural markets, as shown in the model displayed as Fig. 20.2. However, NGOs like BAIF often find themselves unsuccessful at leveraging their own strengths and knowledge about the BOP customers and markets in accessing markets directly either through the traditional brick-and-mortar route or the e-commerce option, as was illustrated in the case study.

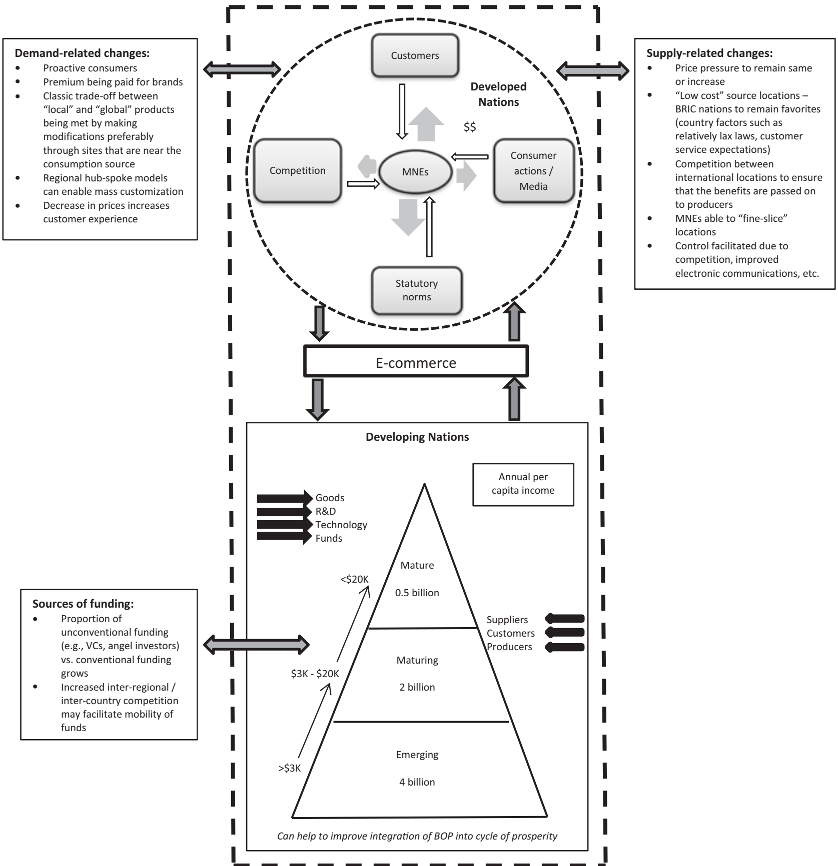


Fig. 20.2 The future of the glo-cal marketplace

Conclusions

In order to facilitate the creation of connections with BOP markets, companies, both domestic and MNEs, may do well to consider the following actions:

1. Collaborate with grassroots organizations, NGOs, so as to obtain inputs for developing, as well as leveraging, the synergies that may result, on the basis that studying NGOs' grassroots models may assist MNEs to understand the value-building proposition offered by these social entrepreneurs, especially interventions that are being used to uplift the poor and assist in the building of sustainable livelihoods. A clear understanding can lead to the development of solutions that align the goals of both parties (MNEs and the NGO). Providing much-needed guidance to NGOs like BAIF can help them to get vital inputs in the areas of marketing, packaging, pricing, and advertising. In the case of BAIF, most of the staff are development specialists and, while they possess experience in that area, there are no marketing specialists. Hiring and retaining such marketing specialists is difficult, due to the high cost of either hiring such experts in-house or seeking external professional services on a "need basis". Hence, although BAIF is in a position to procure an array of products created using sustainable techniques, they are unable to bring them to the market (either in the brick-and-mortar space or the e-commerce space) effectively, as was described in our case study.
2. Companies may also find it worthwhile to invest in e-commerce sales channels, which perform a critical function, especially with respect to the delivery of higher end products that are often produced by MNEs. This additional involvement means that the entire process, from sourcing to the delivery of the product to the end user, is documented and trackable, reducing the risk of bogus product or fraud in countries with less-developed institutional environments and legal protection. Such ventures may, therefore, be strategic investments for MNEs.

It is also important to highlight that, since e-commerce is an emerging area, a universally accepted framework of rules and regulations regarding its governance, with respect to suppliers, employees (internal customers), and clients, is still to be developed.

Acknowledgments The author would like to acknowledge the support provided by BAIF (Pune) in terms of sharing their experiences and providing data for this case study, and Dr. Elizabeth Rose for her feedback and valuable comments, which were very helpful.

Appendix 20.1: List of Abbreviations

APL	Above poverty line
BPL	Below poverty line
CBO	Community-based organizations
CRP	Community resource person
CSR	Corporate social responsibility
FGDs	Focus group discussions
FDI	Foreign direct investment
FMCG	Fast moving consumer goods
GP	Gram Panchayat (Village-level governing body)
GDP	Gross domestic product
INR	Indian rupee
HACCP	Hazard analysis and critical control point
ICT	Information and communication technology
LWE	Left wing extremist affected areas
MFI	Microfinance institution
MNEs	Multinational enterprises
NABARD	National Bank for Agriculture and Rural Development
NGOs	Nongovernment organization
NRLM	National rural livelihood mission
NA	Not applicable
OBC	Other backward castes
RRB	Regional rural banks
SHG	Self-help groups
SHPIs	Self-help promoting institutions
SGSY	Swaranjayanti Gram SwarozgarYojana
TAT	Turn-around times (response time)
WRT	With respect to

Appendix 20.2: About BAIF Development Research Foundation

BAIF Development Research Foundation (formerly registered as the Bharatiya Agro Industries Foundation), is a reputed voluntary organization established in 1967 by Dr. Manibhai Desai, a disciple of Mahatma Gandhi, at Urulikanchan, near Pune to promote sustainable livelihood in Rural India.

The original name Bharatiya Agro Industries Foundation ***(BAIF) also reflects the need for treating agriculture and rural development as an industry***, requiring sound back up of management and motivation to turn the ***farmers into entrepreneurs*** to manage their resources, while generating gainful self-employment in their own environs.

BAIF is committed to provide sustainable livelihood to the rural poor through management of natural resources and promotion of livestock development, watershed development and agri-horti-forestry as major income generation activities.

BAIF is serving over 4.5 million poor families living in ***60,000 villages*** spread over ***16 states*** across the country through the dedicated efforts of over ***4500 employees.***

The major activities of BAIF are promotion of:

- Dairy husbandry,
- Goat husbandry,
- Water resources development,
- Sustainable agriculture,
- Agri-horti-forestry for rehabilitation of tribes on degraded lands,
- And various rural non-farm activities for generating employment for landless families.

Environmental sustainability and empowerment of women cut across all these programs.

Few of the **Awards and Recognition** bestowed on BAIF are as follows:

- India NGO Award 2008 for demonstrating sustainable development, efficient and transparent management

- Indian Innovation Award 2005 for innovative approaches in poverty alleviation
- Vasantrao Naik Jala Samvardhan Award 2005 for innovative approach in watershed development
- Centre of Excellence in Tribal Development by the Ministry of Tribal Affairs, Government of India
- Ministry of Finance, Government of India under section 35 (1) (ii) of the Income Tax Act, 1961 for carrying out Scientific Research
- SILK MARK Certification for promotion of sericulture

**(the exhaustive list of BAIF achievements could be found at: http://www.baif.org.in/about_us_about_baif.asp*)

About Producer Company: VAPCOL

Having realized the need to **ensure sustainability** of the development programs through **promotion of people's organizations**, BAIF facilitated farmers to form primary producer groups/farmer interest groups, such as cooperative societies, farmer associations, and Self-Help Groups (SHGs) federations. Eventually, this collective action gave rise to a federal structure, **VAPCOL.**

VAPCOL was registered as a Producer Company under Companies Act, 1956 in July 2004. The company extends various support services to its member organizations based at Gujarat, Maharashtra, Rajasthan, and other states in India; some of them are registered bodies under the Cooperative Act of concerned states legislation and some are federated informal groups. VAPCOL supports its member organizations in providing them with a range of services such as:

1. Establishing market linkages
2. Sourcing and making available working capital to its member organizations
3. Advisory and capacity building support for member activities
4. Piloting new technologies/techniques-based services
5. Promoting member organizations to introduce new and continuous member services

The company marketed processed products under the brand, "**Vrindavan—from the roots of India**". Today VAPCOL boasts of a total institutional membership base of 55 organizations; each of its member's member base is **(approx.) 1500–2000 farmers.** Thus, through the market linkage initiatives of VAPCOL, the company is able to provide higher bargain and returns to the primary producers at the right time and also at the farm gate. Small and marginal tribal farmers of the operational area (South Gujarat, Maharashtra, and Rajasthan) of the Producer Company today have choice of more than one buyer and market to choose from. ***USP of VAPCOL is providing best quality products to its consumers, without the involvement of any intermediary or agents.***

The range of value-added products of Cashew, Mango, Karvanda, and Amla with VAPCOL is as listed below:

List of products with VAPCOL

#	Product name	Available packing				
1	Mango & Mix Pickle	200 g pouch	250 g pet bottle	400 g pet bottle	1 kg pet bottle	5 kg × 4 jar
2	Lemon, Karvanda, & Chilly Pickle	200 g pouch	250 g pet bottle	400 g pet bottle	1 kg pet bottle	5 kg × 4 jar
3	Sweet Mango Pickle	200 g pouch	250 g pet bottle	500 g pet bottle	1 kg pet bottle	5 kg× 4 jar
4	Sweet lemon Pickle	200 g pouch	250 g pet bottle	500 g pet bottle	1 kg pet bottle	5 kg × 4 jar
5	Mango Chhunda	200 g pouch	250 g pet bottle	500 g pet bottle	1 kg pet bottle	5 kg × 4 jar
6	Methiya Pickle	200 g pouch	250 g pet bottle	400 g pet bottle	1 kg pet bottle	5 kg × 4 jar
7	Mango Slices	100 g pouch				
8	Mango Crush	700 ml pet bottle				
9	Strawberry Crush	700 ml pet bottle				
10	Amla Syrup	700 ml pet bottle				
11	Kokum Syrup	700 ml pet bottle				
12	Amla Juice	700 ml pet bottle				
13	Mix Fruit Jam	500 g bottle				
14	Mango Jam	500 g bottle				
15	Strawberry Jam	500 g bottle				
16	Amla Candy	100 g pouch	200 g pouch			
17	Kesar Mango Pulp	850 g tin	3.1 kg tin			
18	Alphanso Mango Pulp	850 g tin	100 gm pouch			

References

Abramovitz, M. (1986). Catching up, forging ahead and falling behind. *Journal of Economic History, 46*(2), 385–406.

Ashley, C., Start, D., Slater, R., & Deshingkar, P. (2003). Understanding rural livelihoods in India: Diversity, change and exclusion. *ODI Policy Guidance Sheets*. London: Overseas Development Institute (ODI).

ASSOCHAM (2014). *Evolution of e commerce in India – Creating the bricks behind the clicks.* ASSOCHAM-PWC.

Buckley, P. J., & Ghauri. P. N. (2004). Globalisation, economic geography and the strategy of multinational enterprises. *Journal of International Business Studies*, *35*(2), 81–98.

Cuervo-Cazurra, A., & Genc, M. (2008). Transforming disadvantages into advantages: Developing-country MNEs in the least developed countries. *Journal of International Business Studies, 39*(6), 957–979.

Dorward, A., Kydd, J., Morrison, J., & Urey, I. (2004). A policy agenda for pro-poor agricultural growth. *World Development, 32*(1), 73–89.

Forbes (2015). Alibaba: Here are the key growth drivers in the Chinese e-commerce market. http://www.forbes.com/sites/greatspeculations/2015/06/02/alibaba-here-are-the-key-growth-drivers-in-the-chinese-e-commerce-market/#47b44f6a76ae. Retrieved on March 12, 2016.

Fortune (2015). Amazon says it's doubling down on this country. http://fortune.com/2015/07/23/amazon-india-fastest-growing/ Fortune.com, July 23, 2015.

Hammond, A. L. (2007). The next 4 billion. *Innovations, C 2*(1–2), 147–158. WRI.

Hammond, A. L., & Prahalad, C. K. (2004). Selling to the poor. *Foreign Policy*, 30–37.

Hindustan Unilever Limited (2013). Making sustainable living commonplace. https://www.hul.co.in/Images/hul_annual_report_2012-13_tcm1255-436322_en.pdf. Annual Report 2012-13.

Hu, Q. W. (2004). Lessons from Alibaba.com: Government's role in electronic contracting. *info*, *6*(5), 298–307.

Karnani, A. (2005). Misfortune at the bottom of the pyramid. *Greener Management International, 51*, 99–111.

Kim, W. C., & Mauborgne, R. (2005). Blue ocean strategy: From theory to practice. *California Management Review, 47*(3), 105–121.

Luo, Y., & Tung, R. (2007). International expansion of emerging market enterprises. *Journal of International Business Studies, 38*(4), 481–498.
Mudambi, R. (2008). Location, control and innovation in knowledge-intensive industries. *Journal of Economic Geography, 8*(5), 699–725.
Mudambi, R. (2015). *Local enterprise, global value*. http://www.emeraldgrouppublishing.com/bizfocus/mudambi.htm
Ou, C., & Davison, R. M. (2009). Why eBay lost to TaoBao in China : The glocal advantage. *Communications of the ACM, 52*(1), 145–148.
Prahalad, C. K., & Hammond, A. L. (2002). Serving the world's poor, profitably. *Harvard Business Review, 80*(9), 48–59.
Prahalad, C. K., & Ramaswamy, V. (2004). Co-creation experiences: The next practice in value creation. *Journal of Interactive Marketing, 18*(3), 5–14.
Raynor, C. C. (2003). *The innovators solution: Creating and sustaining successful growth*. Boston: Harvard Business School Press.
Rich, R. C. (1980). The dynamics of leadership in neighborhood organizations. *Social Science Quarterly, 60*(4), 570–587.
Seelos, C., & Mair, J. (2005). Social entrepreneurship: Creating new business models to serve the poor. *Business Horizons*, *4*8(3), 241–246.
Simanis, E., Hart, S., & Duke, D. (2008). The base of the pyramid protocol: Beyond "basic needs" business strategies. *Innovations, 3*(1), 57–84.
Vikas, S. (2015). Amazon India sellers can now sell their products to US & UK customers. *Economic Times*, http://tech.economictimes.indiatimes.com/news/internet/amazon-india-sellers-can-now-sell-their-products-to-us-uk-customers/47598434
WBCSD. (2001). *Sustainability through the market: Seven keys to success*. Geneva: World Business Council for Sustainable Development.
Webb, J. W., Kistruck, G. M., Ireland, R. D., & Ketchen, D. J. (2010). The entrepreneurship process in base of the pyramid markets: The case of multinational enterprise/nongovernment organization alliances. *Entrepreneurship Theory and Practice, 34*(3), 555–581.

Index

Note: Page numbers followed by “n” denote notes.

S. Raghunath, E.L. Rose (eds.), *International Business Strategy*,
DOI 10.1057/978-1-137-54468-1

D

G

H

I