



Institutions, resources, and internationalization of emerging economy firms

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ABSTRACT

An important step in the internationalization process of emerging economy firms is the shift from exports to foreign direct investment (FDI). We integrate the resource- and institution-based views to suggest that firms that can use unique institutional advantages are more likely to make this shift. We test these arguments with a longitudinal sample of 28,563 firm-year observations (1989–2005). We found that firms that are affiliated with a business group, have more firm- and group-level international experience, have more technological and marketing resources, and operate in service industries are more likely to shift from exports to FDI.

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1. Introduction

The number of emerging economy (EE) firms expanding into international markets has grown exponentially in recent years, usually through exports (Aulakh, Kotabe, & Teegan, 2000; Yiu, Lau, & Bruton, 2007) although increasingly through foreign direct investment (FDI) (Luo & Tung, 2007). This strategic change, shifting from international operations based primarily on exports to a high-commitment method (FDI), is notable for firms in general (Barkema & Drogendijk, 2007) but for EE firms undergoing accelerated internationalization in particular (Mathews & Zander, 2007). The literature provides limited insights into which factors might induce such a strategic shift though.

As two distinct strategies of internationalization, exports and FDI exhibit different motivations, resource requirements, cost structures, risks, and consequences. Exporting is a low risk strategy for operating in international markets. It requires fewer resources and can be easily reversed. In contrast, FDI demands a greater commitment of resources (McDougall & Oviatt, 2000) and usually cannot be easily reversed. This makes it far more risky as well as more promising, in terms of its high potential returns (Lu & Beamish, 2001). The strategic shift from an international operating strategy based on exports to one that combines FDI with exports represents a major change in the firm's international commitment

(Barkema & Drogendijk, 2007) and involves several challenges. A natural question thus emerges: Which factors enable EE firms to make this strategic change? In this study, we adopt a multi-theoretical approach, integrating the resource-based view (RBV) and institution-based view (IBV), to address this question, together with empirical evidence gathered from a large, novel panel data set that describes firms from the second largest EE, namely, India.

We contribute to the literature in three ways. First, by integrating the RBV and IBV, we provide a useful theoretical framework for analyzing the internationalization process by EE firms. Emerging economy firms may suffer weak resource bases in terms of traditional resources (Hitt, Dacin, Levitas, Arregle, & Borza, 2000). However, they often compensate for this weakness by using non-traditional, network-based resources that arise from the unique institutional and industrial characteristics of the environment in which these firms are embedded (Cuervo-Cazurra & Genc, 2008; Elango & Pattnaik, 2007). Outward FDI offers a means to escape the weak home country institutional environment (Witt & Lewin, 2007) for many EE firms. The institutional evolution that characterizes many EEs has led to rapid transformation in the competitiveness of certain key industries, such as business process outsourcing (BPO), in India (Peng, Wang, & Jiang, 2008). The quick rise to global dominance of these EE industries is largely attributable to the liberalization of industrial policies, including vast private and foreign participation. Noting these complex linkages among resources, institutions, and industries, we offer an inclusive, integrative theoretical framework for studying EE firm internationalization (Contractor, Kumar, & Kundu, 2007; Yamakawa, Peng, & Deeds, 2008).

Second, this study offers a clearer understanding of the antecedents of the change from exports to FDI. The stages model of firm internationalization suggests that internationalization

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typically occurs in a set of steps, from licensing to exporting to FDI (Johanson & Vahlne, 1977). Each step has different requirements and reflects a different set of strategic choices. An organization thus learns from each form of internationalization and moves to the next more complex form over time as it establishes a critical mass of knowledge and discovers new opportunities. The stages model is extensively studied, but it has not previously been applied to the shift from exports to FDI. We thus conceptualize internationalization as a “package” of international operating strategies, which the firm uses to increase its commitment to internationalization (Benito, Petersen, & Welch, 2009).

Third, with our unique study context, we help augment understanding of the stages model. Strategic change literature recognizes the importance of resources as enablers of strategic change. In an EE context, a firm’s resources are constrained, and the institutional environment is less structured than in a mature economy. We need to analyze what enables firms to change from one strategy to another (Bruton, Ahlstrom, & Han-Lin, 2010). Situating our study in an emerging market context enables us to investigate this theoretical issue. Several scholars similarly have suggested that EE markets provide laboratory settings for effective tests of new theoretical insights and arguments (Wright, Filatotchev, Hoskisson, & Peng, 2005).

In contrast, most research on EEs has focused on developed economy firms entering EEs or domestic competition within EEs (Hoskisson, Eden, Lau, & Wright, 2000). Research pertaining to internationalization by EE firms offers deeper insights on the factors that affect EE firm exports (Aulakh et al., 2000; Filatotchev, Liu, Buck, & Wright, 2009) or FDI (Buckley et al., 2007; Yiu et al., 2007) but do not address the strategic change between them. Hitt, Tihanyi, Miller, and Connelley (2006), in a review of international diversification literature, note that studies of EE firms’ internationalization would add value to international management research. We respond to this call and seek to develop a better understanding of factors effecting change in a firm’s international operating strategy.

2. Theory and hypotheses

2.1. Background

Multi-theoretic approaches can be used to examine complex strategic choices, such as those related to firm internationalization in emerging markets (Yamakawa et al., 2008). For example, the RBV and IBV, both which appear in prior work that seeks to explain the strategic behavior of EE firms (Meyer, Estrin, Bhaumik, & Peng, 2009; Peng et al., 2008) likely interact. It is often difficult to compartmentalize the effects of resources versus institutions (Meyer et al., 2009). Accordingly, we develop our theory for this research by integrating the RBV and IBV.

The RBV asserts that firm-specific heterogeneity, in terms of resources and capabilities, determines firms’ strategic choices (Barney, 1991), including those pertaining to international business operations. Resources and ownership-specific advantages are important for the internationalization of any firm (Tallman & Fladmoe-Lindquist, 2002). We argue that the way in which EE firms rely on their resources differs from that used by developed economy firms. Because EE firms often lack the traditional resources used to overcome the liability of foreignness, they turn to different types of resources, such as an ethnic customer base, cheap labor, or a dominant position in their home markets.

Using the RBV as a theoretical lens, Miller, Thomas, Eden, and Hitt (2008) argue that EE firms use their ethnic identity to survive in foreign markets. The prevalence of ethnically similar customers and competitors acts as a source of motivation and a basis for

developing rare and inimitable resources to support EE firms’ internationalization into developed economies. Ghymn (1980) demonstrates that Korean construction companies use domestic manpower for their FDI operations in Middle Eastern countries; similarly, Indian software companies make extensive use of their domestic manpower in their international operations—a notion that is virtually unheard of in the context of developed economy firms. Operating in difficult home country environments also improves EE firms’ capabilities to manage in conditions of scarcity (Cuervo-Cazurra & Genc, 2008; del Sol & Kogan, 2007). For example, their production know-how emerges from unique capabilities in labor-intensive, small-scale manufacturing, and their marketing know-how reflects their ability to serve specialized, niche market segments, such as small expatriate ethnic communities (Wells, 1983).

Furthermore, unlike their counterparts from developed markets, EE firms use internationalization to gain competitive advantage in both foreign and domestic markets. While developed market firms tend to exploit their ownership-specific advantages to gain competitive advantages in foreign markets, EE firms develop and acquire new capabilities as they expand internationally (Aulakh, 2007). These newly acquired capabilities, along with their existing resources, help them compete in foreign markets and in their domestic markets (Kumaraswamy, Mudambi, Saranga, & Tripathy, 2012). Although firm resources are critical for both types of internationalizing firms, a key difference pertains to how they acquire and use those resources. Because FDI requires far more resources than exporting, EE firms in possession of greater firm resources are better equipped to shift from exports to FDI.

According to the IBV, institutions have the greatest effect on firm strategy and performance (Peng et al., 2008). Well-developed institutions enable firms to conduct business more efficiently using the market; underdeveloped institutions create higher transaction costs and make market-based exchanges less efficient. Although EEs are often characterized by weak institutions (Hoskisson et al., 2000; Wright et al., 2005), in many cases those institutions also are undergoing substantial reforms, which alter the nature of competition (Hoskisson et al., 2000). We posit that the (generally weak) nature of EE institutions and their modern changes produce institution-based advantages and stronger motivation for firms to commit greater resources to their international operations. There are three salient points.

First, some EE firms actively seek to escape stifling regulatory constraints at home or overcome negative country-of-origin effects and acquire legitimacy in international markets by investing abroad (Gaur & Kumar, 2010). Others view their home experience as a valuable resource to be exploited in other, similar foreign markets (Niosi & Tschang, 2009). For example, Cuervo-Cazurra and Genc (2008) show that EE multinationals enjoy a competitive advantage over their developed economy counterparts when they seek to enter and operate in other EEs because they have gained experience with operating in environments characterized with underdeveloped institutions and difficult governance conditions. Buckley et al. (2007) also note that Chinese FDI gets attracted, rather than deterred, by political risk, perhaps explaining the huge Chinese investments in many African nations marred by political instability.

Second, several EE industries (e.g. telecom, retail, insurance) historically have experienced minimal competition, particularly from foreign players. Institutional reforms are opening these industries to foreign players, exposing the domestic players to a higher degree of competition (Hoskisson et al., 2000). Higher industry competition through greater foreign participation may drive some EE firms to expand into international markets with more commitment, in search of new markets and to avoid clashes

with other incumbents (Dawar & Frost, 1999). Furthermore, eased regulatory controls, such as in the services sector in India, have unleashed an entrepreneurial spirit and been a tremendous impetus to the internationalization of Indian service firms.

Third, many EE firms organize into business group networks to overcome the high transaction costs imposed by institutional voids (Wright et al., 2005). Khanna and Rivkin (2001, pp. 47–48) define business groups as “a set of firms which, though legally independent, are bound together by a constellation of formal and informal ties, and are accustomed to taking coordinated action.” They emerge in response to imperfect or missing markets (Leff, 1978), as a result of strong interpersonal relationships among families or clans (Granovetter, 1994), or due to active or passive government support, such as access to capital through loan guarantees (Ghemawat & Khanna, 1998; Guillen, 2000). The formation of business groups and the unique attributes of firms affiliated with them also reflect the institutional environment of EEs. By capturing traits associated with affiliation with a business group, we thus can capture unique elements of the EE institutional environment. For example, access to a common pool of resources—capital, labor, FDI experience—through strong networking by individual firms is unique to firms that have responded appropriately to the prevailing institutional environment (Elango & Pattnaik, 2007). The resources available to group-affiliated firms then can be traced back to their responses to their unique institutional conditions. These advantages represent institutional resources for our study. In Fig. 1 we present our theoretical model, which we elaborate in the following sections.

2.2. Institutional advantages

2.2.1. Business groups

In response to the prevailing institutional environment (well- or underdeveloped), firms adopt specific strategies. For example, firms operating in well-developed institutional environments tend to adopt a more focused strategy in terms of products and industries, whereas firms operating in underdeveloped institutional environment generally diversify into multiple products and industries (Khanna & Palepu, 1997). Many EE firms achieve such diversification by organizing as business groups, which may also exist in developed economies but not with the same prevalence (Yiu et al., 2007).

There are several benefits for business group affiliated firms in their domestic markets. For example, EEs lack the formal and informal institutions needed for efficient market-based exchanges; business groups fill the voids created by the lack of such institutions (Khanna & Palepu, 1997, 2000) and thus enable the affiliated firms to conduct their business. Institutional environments in EEs also are riskier, due to the uncertain economic and political systems. Managing political risk and developing mechanisms to cope with and benefit from such political risks are critical to the success of EE firms. Firms that can control the sources and supplies of their raw materials, as well as the sales of their final products to end consumers, are in a better position to guard against risks. Affiliation with business groups provides firms with capabilities, in that they can rely on the group's reputation and resources. Group-affiliated firms also have broader, relatively easy access to capital, both internal and foreign, and can access labor and product markets more easily than can firms that are not part of any business group (Khanna & Rivkin, 2001). However, it is not clear how these resource advantages translate into similar advantages in foreign markets with different, often more developed, institutional environments.

We posit that group-affiliated firms derive resource advantages from a stronger domestic position, which leads affiliated firms with risk-taking ability to venture into international markets through high commitment modes such as FDI. Internationalization through FDI involves a substantive commitment of financial and other resources, which might be easier to undertake and manage for a group-affiliated firm than for an unaffiliated firm (Chari, 2012). Unaffiliated firms may find it difficult to access such resources and need to develop them in-house, which is often an expensive, lengthy process. In addition, firms indulging in FDI should be willing to take a long position and bear losses in the short run. Cross-subsidization across group companies makes it easier for a group-affiliated firm to bear such short-term losses. Thus, business group affiliation provides a strong resource advantage, incentives, and motivations to affiliated firms, which should make it easier for them to shift from exports to FDI.

Hypothesis 1. Firms are more likely to shift from exports to FDI if they are affiliated with a business group.

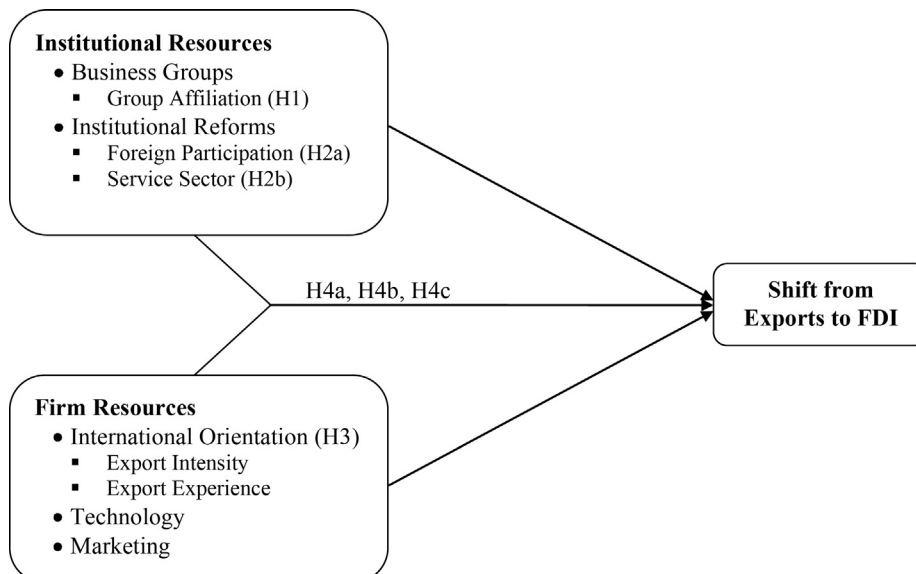


Fig. 1. Theoretical model.

2.2.2. Institutional reforms

Economies such as India and China are in a state of institutional transition, such that they encourage greater levels of competition by easing regulatory bottlenecks and providing the needed infrastructural support (Zattoni, Pedersen, & Kumar, 2009). The process of institutional transition has not been smooth across different sectors of the economy though. For example, India's capital and product markets have witnessed significant improvements, but the labor market continues to remain inflexible and rigid with little signs of change, even after a major liberalization drive in the early 1990s. Accordingly, some sectors, such as BPO, have evolved into internationally competitive industries, while others have not (Peng et al., 2008). It is not uncommon for institutional change to be uneven across sectors. Institutional theorists argue that institutions are either formal or informal (North, 1990). It is easy to change the formal rules that govern institutions, but informal norms resist and often take much longer to change (Gaur, 2007). When an institutional change occurs, some sectors of the economy require changes to both formal and informal aspects, whereas others require less extensive changes in either institutional aspect, or both.

Manufacturing and service sectors in India clearly demonstrate the differential impacts of broader institutional changes. For service industries, it has been relatively easy to carry out reforms and provide the infrastructure needed for smooth operations. India transformed its telecommunication industry quickly by deregulating the spectrum allocation for providing value-added services. Because the telecom industry itself was new, few informal rules needed to be changed, and the formal rules could be changed easily. As a result, the telecom revolution in India has made this industry the second largest in the world, after the United States, with a base of about 890 million subscribers. The changes also enabled other firms to undertake outsourcing using India's advanced telecommunication infrastructure. In contrast, the reforms needed for manufacturing industries demanded greater public investments in infrastructure projects, such as roads and ports. Such investments require government intervention, which has been slow to materialize, due to the inefficiencies inherent in government projects in EEs. A case in point is Bangalore, the "Silicon Valley of India." Bangalore is known for its world-class information technology companies, yet roads and other public infrastructure facilities remain poor in this city. Thus, service industries clearly have benefited to a much greater extent from the institutional transition than other industries.

Institutional reforms in EEs make some industries intensely competitive domestically, which may drive some firms abroad in search of better opportunities and to avoid increasing competition at home (Yamakawa et al., 2008). Furthermore, a greater foreign presence in certain industries grants opportunities to domestic firms in those industries to form strategic alliances as outsourcing providers; in the process, they gain knowledge about foreign management styles more suited to foreign markets. The service sector in India is characterized by such alliances, due to the rapid pace of change in the service sector. Competitive pressures in domestic markets, as well as the possibility of achieving superior competitive advantage through internationalization (Aulakh, 2007), drive many service sector firms to shift from exports to FDI.

Hypothesis 2. Firms in the service sector are more likely to shift from exports to FDI than are firms in the manufacturing sector.

2.3. Firm-specific advantages

2.3.1. International experience

The importance of international experience for the success of internationalization initiatives is well documented (Delios & Beamish, 2001). Filatotchev et al. (2009) demonstrate that

international experience-related factors, such as the founder's international background and global networks and the presence of a "returnee" entrepreneur, exert positive influences on export orientation and performance in high-tech EE firms. Scholars show that firms that have more experience operating in a host country have a greater likelihood of sustaining their foreign investments (Delios & Beamish, 2001). Although host country specific-experience is important for the success of foreign investments, just having more general knowledge of operating in foreign markets also benefits internationalization initiatives (Barkema, Bell, & Pennings, 1996).

In contrast, EE firms that have only exported may not have host country-specific experience, though they have general knowledge of operating in foreign markets. To operate successfully in export markets, firms must change their processes to satisfy new design and operational specifications and enhance their product quality (Singh, 2009). Serving multiple clients in remote locations is often more difficult than serving them from within host countries (Kedia & Mukherjee, 2009). In this sense, exporting activities lead to learning about foreign markets that can be used to design more effective and committed investment strategies for those markets later. That is, prior export experience encourages successful FDI, and a prior stock of exporting acts as a trigger to encourage a shift from exports to FDI to gain more benefits from internationalization. Accordingly, we hypothesize:

Hypothesis 3. Firms with greater levels of international experience (measured by export intensity and export experience) are more likely to shift from exports to FDI.

In addition to international experience, other traditional resources influence internationalization by EE firms, just as in the case of developed economy firms (Gaur & Kumar, 2010). Because the effect of traditional resources on firm internationalization has been relatively well studied, we do not propose related hypotheses. However, we expect a positive effect of traditional resources, which, as we argue next, becomes magnified in the presence of institutional resources, such as business group affiliation.

2.3.2. Joint effects of firm and institutional advantages

Meyer et al. (2009) argue that institutions moderate the resource-based considerations for foreign entry strategies into EEs. The institutional environment of emerging markets affects the way tangible and intangible resources can be acquired, developed, and exploited. We posit that these arguments hold when considering EE firms' international operating strategies too. The value of traditional firm resources increases when combined with non-traditional institutional resources that emanate from unique institutional and industrial environments, as are prevalent in EEs. For example, firms affiliated with a business group may be able to rely on the international experience of other affiliated firms, even if they lack such experience.

The network structure of a business group allows affiliated firms to draw on knowledge that may be available anywhere in the network, through the rotation of key employees across different group-affiliated companies in intercompany transfers (Kumar, Gaur, & Pattnaik, 2012). Internationalization through FDI improves the group's reputation (Gaur & Kumar, 2010), and the member firms of a business group tend to be keen to participate in such reputation building exercises. Nor do they hesitate to part with key employees or resources if doing so helps other affiliated firms achieve successful FDI. In turn, the international experience of other affiliated member firms is as beneficial as experience gained through the firm's own operations. For example, in Japanese *keiretsu* networks, firms replicate their relationship patterns, developed in the domestic market, as they enter foreign markets (Gaur & Lu, 2007). Business group firms from EEs likely act similarly when they

enter foreign markets. Thus, FDI by one group-affiliated firm may open the doors for similar FDI by other members, and we hypothesize:

Hypothesis 4a. Firms are more likely to shift from exports to FDI if other affiliated firms of the same business group have engaged in FDI.

Similar to international experience, resources such as marketing and technological capabilities become augmented through the firm's affiliation with the business group. This is accomplished through several mechanisms. Marketing tactics or research and development conducted by one firm often are complimentary to the parallel efforts by affiliated firms. For example, TISCO and TELCO are two affiliated companies of the Tata Group in India, operating in the mining/steel and automobile sectors, respectively. Research by TISCO that goes into making high-quality steel is often used by TELCO, the automobile firm. These affiliated firms can benefit by capitalizing on common brand names and the group's overall market reputation, as well as from accessing technology residing in the group to enhance their own technological capability and compete in technologically advanced foreign markets through FDI.

In contrast, a standalone firm would need to rely on resources that it has acquired or developed on its own. A group-affiliated firm may be able to exploit an opportunity for foreign expansion by drawing on resources available to other sister firms, but a standalone firm must either develop these resources on its own or forgo foreign expansion opportunities. We predict that the impact of traditional firm resources on the shift in a firm's international operating strategy, from exports to FDI, increases when combined with institutional resources, such as being affiliated with a business group. Accordingly, we hypothesize:

Hypothesis 4b. The positive effect of technological resources on a firm's likelihood to shift from exports to FDI is stronger if the firm is affiliated with a business group.

Hypothesis 4c. The positive effect of marketing resources on a firm's likelihood to shift from exports to FDI is stronger if the firm is affiliated with a business group.

3. Methods

3.1. Setting

We use the international expansion of Indian firms as the setting for this study. Two important features of Indian firms' international expansion make this empirical context appropriate for testing our hypotheses. First, Indian firms arrived on the international stage relatively late, compared with their counterparts from other EEs, such as China and South-East Asian countries. India was a closed economy until 1991. Most international expansion by Indian firms has happened in past 10 years. [Delios, Gaur, and Kamal \(2009\)](#), in their analysis of globalization by Indian firms, find that the majority of outward FDI happened after 2000. This feature limits concerns about left-censoring, which is an issue for other empirical settings marked by outward investments of firms from other regions (e.g., China, South East Asia) with high FDI outflows among EEs. Second, an Indian setting allows us to test for several unique institutional features, such as business group affiliation and group-level internationalization, that are at the core of our theoretical arguments.

3.2. Data source and sample

We derive a list of firms from the Prowess database of the Center for Monitoring the Indian Economy. The 2005 edition of

Prowess contains data about 10,000 firms, from 1989 until 2005, including all companies traded on India's major stock exchanges, central public sector enterprises, and foreign enterprises. These companies account for 75% of all corporate taxes and more than 95% of the excise duty collected by the federal government ([CMIE, 2012](#)). We constructed a longitudinal profile of international expansion activity. The unit of analysis is each firm's international investment decision. We only included firms that had positive exports for at least two consecutive years during the 17-year period of our study. This restriction generated a sample of 28,563 firm-year observations.

3.2.1. Dependent variable

We developed a FDI decision variable that enabled us to test the rate of response (likelihood of a firm shifting from exports to FDI). To mark the decision by a firm to shift from exports to FDI in a given year, we created an indicator variable that takes a value of 1 if a firm engaged in FDI in the given year, and 0 otherwise. We did not calculate the absolute amount of FDI, because our objective is to analyze a change in the international operating strategy of a firm.

3.2.2. Explanatory variables

The explanatory variables included firm-level technological and marketing resources, firm-level international experience, business group affiliation, group-level international experience, foreign participation at the industry level, and a service industry indicator. We measured technological and marketing capabilities by taking a natural logarithm of the total R&D and total marketing expenditures incurred by a firm. For firm-level international experience, we used two variables: export intensity and export experience ([Delios, Gaur, & Makino, 2008](#); [Gaur & Lu, 2007](#)). Export intensity represented a ratio of foreign sales to total sales. Export experience was the number of years from the first export to the year in which a firm first undertook a FDI. We took a natural logarithm of this count variable in our analyses.

We measured business group affiliation with an indicator variable that took a value of 1 if the firm was affiliated with a business group and 0 otherwise. We measured group-level international experience using a cumulative count of the total number of FDIs made by all firms affiliated with the group, then took the natural logarithm of this count variable. Finally, we used a service industry indicator variable, equal to 1 if the firm belonged to the services sector and 0 otherwise.

3.2.3. Control variables

We controlled for firm size, firm age, the debt-to-equity ratio, prior profitability, and extent of foreign participation in an industry. We measured firm size as the natural logarithm of total assets. Firm age equaled the total number of years since the firm's inception. Debt-to-equity ratio was the ratio of total debt to total equity at the end of the financial year. For prior profitability, we used profit after tax, lagged by one year. We measured foreign participation as the ratio of foreign firms to domestic firms at the three-digit national industrial classification level (equivalent to the standard industrial classification code).

3.3. Modeling procedure

We used an exponential event history estimation in which no age-parametric dependence was specified in its functional form ([Blossfeld & Rohwer, 1995](#)), to investigate the event of a shift from exports to FDI. We tested the robustness of our results using panel data logit estimation. The results of the two estimation procedures were qualitatively similar, so we report the results based on the exponential event history estimation here.

4. Results

Table 1 contains the correlation matrix and descriptive statistics for all variables in our models. Although FDI among Indian firms remained relatively uncommon, we found a high level of export intensity, with a mean of 19%. The group-level FDI variable correlated highly with the group affiliation variable, raising concerns about the deleterious effects of multicollinearity on our coefficient estimates. To address this problem, we entered the group affiliation and group FDI variables in two different models.

Table 2 contains the results of our exponential models. Model 1 included the control variables, as well as the variables related to the institutional explanation of a firm's propensity to shift from exports to FDI. In Model 2, we added the two variables measuring firm-level international experience. In Models 3–5, we test for the joint effect of institutional and firm-level advantages. Because group-level international experience correlated highly with the business group affiliation variable, we removed the group affiliation variable from Model 3 and the group-level international experience variable from Models 4 and 5.

In line with our prediction in H1, business group-affiliated firms were more likely to shift from exports to FDI; the group affiliation variable was positive and significant (Model 1: $\beta = 0.277, p < 0.05$). We also predicted that firms belonging to the services sector would be more likely to make this shift; the positive, significant coefficient of the service industry indicator variable (Model 1: $\beta = 1.259, p < 0.001$) offered support for H2. Thus, firms with institutional advantages in emerging economies find it easier to make a shift from exports to FDI.

We also considered the effects of firm-specific resources. Although not hypothesized, we found a positive, significant effect of marketing and R&D expenses on a firm's propensity to shift from exports to FDI. Furthermore, in H3 we suggested that firms with greater international experience would be more likely to transition from exports to FDI. The coefficients for export intensity (Model 2: $\beta = 0.166, p < 0.001$) and export experience (Model 2: $\beta = 1.941, p < 0.001$) were positive and significant, in support of H3.

Next, we noted the combined effect of institutional and firm-specific advantages. In H4a we predicted that firms belonging to business groups, in which other affiliated firms have already made FDI, were more likely to shift from exports to FDI. The coefficient

Table 1
Descriptive statistics and correlations.^{a,b}

Variables	Mean	S.D.	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.
1. FDI event (=1)	0.01	0.10	–												
2. Size ^c	3.99	1.80	0.07	–											
3. Age	25.87	21.14	0.02	0.29	–										
4. Debt to equity	2.76	41.38	0.00	0.00	–0.01	–									
5. Prior profitability ^d	16.99	168.74	0.04	0.24	0.06	–0.01	–								
6. R&D expense ^c	0.19	0.57	0.08	0.43	0.18	–0.01	0.30	–							
7. Marketing expense ^c	0.75	0.98	0.07	0.63	0.24	0.00	0.18	0.47	–						
8. Export intensity	0.19	0.59	0.03	–0.09	–0.10	–0.01	–0.01	–0.03	–0.05	–					
9. Export exp.	1.63	0.73	0.09	0.32	0.32	0.01	0.07	0.22	0.29	–0.03	–				
10. Group affiliation (=1)	0.47	0.50	0.03	0.30	0.17	0.00	0.00	0.14	0.24	–0.04	0.12	–			
11. Group FDI#	0.02	0.16	0.39	0.11	0.04	0.00	0.07	0.09	0.10	0.00	0.12	0.65	–		
12. Foreign participation	0.06	0.06	0.01	0.06	0.07	0.01	0.04	0.23	0.15	–0.05	0.06	0.00	0.01	–	
13. Service sector	0.20	0.40	0.06	–0.06	–0.05	0.00	0.04	–0.10	–0.10	0.06	–0.03	0.02	0.06	–0.08	–

^a Based on a sample of 28,563 firm-year observations during 1989–2007.

^b Natural logarithm.

^c Correlation greater than |0.01|, significant at $p = 0.05$.

^d In billions of Indian Rupees.

Table 2
Exponential event history analysis (event: shift from exports to FDI).

	Model 1		Model 2		Model 3		Model 4		Model 5	
	B	S.E.	B	S.E.	B	S.E.	B	S.E.	B	S.E.
Size	0.193 ^{***}	(0.044)	0.099 [*]	(0.043)	0.022	(0.043)	0.111 ^{**}	(0.044)	0.125 ^{**}	(0.043)
Age	–0.004	(0.003)	–0.018 ^{***}	(0.003)	–0.020 ^{***}	(0.003)	–0.018 ^{***}	(0.003)	–0.019 ^{***}	(0.003)
Debt to equity	–0.183	(1.766)	–0.356	(2.094)	–0.352	(2.280)	–0.339	(2.081)	–0.279	(2.012)
Prior profitability	–0.213	(0.168)	–0.166	(0.160)	–0.341 [†]	(0.186)	–0.121	(0.170)	–0.085	(0.168)
R&D expense	0.383 ^{***}	(0.065)	0.330 ^{***}	(0.066)	0.256 ^{***}	(0.069)	0.122	(0.136)	0.264 ^{***}	(0.070)
Marketing expense	0.164 ^{**}	(0.056)	0.103 [†]	(0.057)	0.157 ^{**}	(0.058)	0.093 [†]	(0.058)	–0.176 [†]	(0.099)
Foreign participation	–0.154	(0.937)	0.089	(0.937)	–0.538	(0.951)	0.217	(0.937)	0.471	(0.928)
Group affiliation (=1) (H1)	0.277 ^{**}	(0.123)	0.216 [†]	(0.123)			0.103	(0.135)	–0.244	(0.165)
Service sector (H2)	1.259 ^{***}	(0.122)	1.313 ^{***}	(0.123)	0.930 ^{***}	(0.127)	1.298 ^{***}	(0.123)	1.316 ^{***}	(0.123)
Export intensity (H3)			0.116 ^{**}	(0.027)	0.115 ^{**}	(0.028)	0.118 ^{**}	(0.027)	0.123 ^{***}	(0.027)
Export experience (H3)			1.941 ^{***}	(0.151)	1.405 ^{***}	(0.142)	1.943 ^{***}	(0.151)	1.953 ^{***}	(0.152)
Group FDI (H4a)					1.810 ^{**}	(0.077)				
Group × R&D expense (H4b)							0.248 [*]	(0.129)		
Group × Marketing expense (H4c)									0.400 ^{***}	(0.102)
χ^2		274.18		515.06		886.71		519.04		533.49
Log likelihood		–1552.48		–1432.03		–1246.20		–1430.05		–1422.82

Notes: n (firm-year) = 28,563.

^{*} $p < 0.05$.

^{**} $p < 0.01$.

^{***} $p < 0.001$.

[†] $p < 0.10$ (all two-tailed tests).

for the group FDI variable was positive and significant (Model 3: $\beta = 1.810$, $p < 0.01$), in support of H4a. Group-affiliated firms benefited more from technological and marketing capabilities than unaffiliated firms. Specifically, the interaction variable between group affiliation and technological capabilities was positive and significant (Model 2: $\beta = 0.248$, $p < 0.05$), in support of H4b, as was the interaction variable between group affiliation and marketing capabilities (Model 2: $\beta = 0.400$, $p < 0.001$), in support of H4c. Together, these significant interactions suggest that the positive effect of traditional resources becomes amplified in the presence of institutional advantages.

5. Discussion

We investigated an important phenomenon in the internationalization process of EE firms, namely, the change from exporting to FDI. Firms that are rich in both traditional and non-traditional resources, which reflect the unique institutional characteristics of EEs, find it easier and are more likely to make this change to operate and profit from international operations. Specifically, we suggested and found a positive link between firm-level international experience, as measured by export intensity and export experience, and the firm's propensity to change from exports to FDI. We also revealed that firms benefit from non-traditional institutional resources, such as affiliation with a business group and belonging to service sector. Noting the combined effect of firm-specific and institutional resources, we also suggest that the positive effect of firm-specific resources, such as technological and marketing capabilities, becomes amplified for firms that are affiliated with a business group.

The findings confirm these hypotheses; both institutional and firm-specific resources, individually and jointly, help firms make the shift from exports to FDI. Firms affiliated with business groups find it easier to make this change. With respect to the effect of institutional changes, firms belonging to a service sector find it easier to change. Firm-level export experience and export intensity both exhibit positive relationships with the firm's propensity to make a change from exports to FDI. Although we did not develop unique hypotheses about traditional resources, such as technological and marketing capabilities, we found positive relationships between these resources and a firm's propensity to shift from exports to FDI. Finally, the positive effect of firm-level international experience and other traditional resources was stronger for firms affiliated with a business group than for stand-alone firms.

Our study thus contributes to resource-based explanations of EE firms by reiterating the importance of traditional and institutional resources for firm internationalization. The context of EE multinational firms augments the explanatory power of the RBV, by identifying the unique resources these firms possess and that aid their internationalization activities. Asset-seeking and asset-augmenting FDI strategies, unlike traditional asset-exploiting strategies, have gained prominence for explaining EE firm internationalization (Makino, Lau, & Yeh, 2002). This view emerged partly from the general observations of that EE firms, even without a traditional resource base, still were able to internationalize. Yet our findings regarding technological resources and the propensity to change from exports to FDI suggests the need for greater caution before making such generalizations. That is, EE firms may have smaller pools of traditional resources, but these resources still have effects on their international expansion. Our findings are also in line with recent arguments by Ramamurti (2009), in his study of emerging multinationals from India, that many EE firms actually possess unique, firm-specific assets, on which basis they expand their international operations. Our study seeks to alleviate the simplistic perception that EE firms do not possess any ownership advantages (Gaur & Kumar, 2010).

We also found that the considerable resources and capabilities that EE firms exploit in their internationalization processes emanate from their unique institutional environment. We refer to these resources as institutional, because they emerge from the prevailing institutional environment (Cuervo-Cazurra & Genc, 2008; del Sol & Kogan, 2007). Institutional resources are non-traditional, in the sense that they have not received adequate attention in analyses of the internationalization strategy of more established, traditional multinationals from developed economies. Traditional firm resources are important determinants of EE firm internationalization, but institutional resources play an equally critical role, by themselves and in conjunction with traditional resources.

Our finding that firms affiliated with business groups find it easier to shift from exports to FDI is consistent with a recent study that specifically tests the relationship between business group affiliation and FDI in an Indian context (Chari, 2012). It shows that business group affiliates have greater amounts of FDI, overall and in specific markets, compared with stand-alone firms. Our finding pertaining to service sector firms affirms that the industry context matters (Merchant & Gaur, 2008) and may help explain the rapid global expansion of the Indian IT/BPO industry. Our finding that the effects of technological and marketing capabilities are enhanced by the institutional effect of business group affiliation also matches the revised conceptualization of the Ownership-Location-Internalization paradigm (Dunning & Lundan, 2008), which acknowledges the role of institutions for building ownership advantages.

Finally, our study contributes to the stages model of international expansion by focusing on an important step, namely, the shift from exports to FDI. Prior EE firm internationalization literature suggests that some firms tend to jump from no or minimal involvement to direct investments in foreign subsidiaries (Lecraw, 1993). This prediction has gained momentum in descriptions of accelerated internationalization (Mathews, 2006). Most scholars attempt to explain this process of rapid internationalization only by alluding to the role of exports, despite the presence of established learning advantages from exporting. For example, Luo and Tung (2007) offer a "springboard perspective" on EE firm internationalization. They suggest that EE firms overcome their latecomer disadvantages through aggressive acquisitions of assets from mature multinationals. Mathews (2006) proposes a "Linkage, Leverage, Learning" (LLL) framework to describe the unique ability of some EE firms to partner with foreign firms, leverage those partnerships for global competitiveness, and continuously learn in the process to internationalize their operations more quickly. However, this accelerated internationalization of EE firms is determined, to a large extent, by the prior stock of international experience gained through exports; in that sense, it may be less accelerated than these models propose. Some elements of the Uppsala model of internationalization (Johanson & Vahlne, 1977) instead may be more applicable to EE firm internationalization. For strategic change literature (Bruton et al., 2010), our study also provides evidence about a unique dependent variable, in an EE context that previously has not been examined.

6. Managerial relevance

Our study provides several pointers for managers. First, we propose a comprehensive view of the antecedents of a change in international operation modes. As EE firms increase the scope of their international operations, they need to shift from low involvement modes, such as exports and licensing, to high involvement modes, such as joint ventures and wholly owned subsidiaries. The successful implementation of these strategies demands a clear understanding of the factors that underlie a

successful change in firm strategies. Our study suggests that traditional resources remain important for firms that decide to change their international scope. In contrast with the conventional wisdom that EE firms lack traditional resources and ownership-specific advantages, and thus might not need them to compete effectively in foreign markets, we observed that though these firms may have weaker traditional resources, those that possess them find it easier to make the shift. Managers must acknowledge the importance of traditional resources if they hope to increase the international scope of their business operations.

Second, managers need a good understanding of the foreign markets in which they seek to operate and to succeed by entering them aggressively. Prior export experience and export intensity serve as effective learning grounds for EE firms before they make a strategic change in their international operating strategy. Third, managers of EE firms should use their unique institutional environment, which enables their firms to develop other, network-based resources, to compensate for traditional resource weaknesses. Specifically, business group affiliation in EEs provides firms with competitive advantages when they embark on major internationalization initiatives. Thus, it may be advantageous for firms to adopt a business group organizational structure, to make use of shared resources and gain legitimacy in the external environment.

7. Limitations and further research directions

Additional research should address the limitations of our study. First, the empirical setting of our study is India, which limits the generalizability of our findings to other EEs. Even though the theoretical arguments we have proposed are context free and should apply to other EEs in which firms enjoy institutional advantages, such as those arising from networks, it would be helpful to validate our arguments in other settings. Second, we only analyze a change in international operating strategy, from exports to FDI, which does not cover the entire range of activities in internationalization processes. Further research should consider other milestones in the internationalization process, as well as different FDI modes by EE firms. Third, we tested for only one type of network-related resources, that is, those arising due to group affiliation. Group affiliation is an important and unique phenomenon in EEs, but several other network-related resources are available to these firms. For example, networks of CEOs and board members may provide invaluable resources. Further studies should explore this and other network-related benefits that make it easier for firms to internationalize.

Internationalization by EE firms is a recent phenomenon, about which we have limited understanding. Our empirical investigation offers support for the conventional wisdom related to the importance of resources, both traditional and non-traditional, for successful strategy implementation—for our study, the strategy of shifting international operations from exports to FDI. These findings call for greater attention to the ability to manage institutional idiosyncrasies as a firm-level capability, akin to technology or advertising (Henisz, 2003). Considering the rising importance of EE multinationals, and the paucity of literature in this field, we hope that our study ignites additional scholarly interest in this area.

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