CONVERTING COUNTRY-SPECIFIC ADVANTAGES INTO
FIRM-SPECIFIC ADVANTAGES IN EMERGING MARKETS

Abstract

Scholars have suggested that the origins of firm-specific advantages (FSAs) are the local environment in which a firm is based. However, the extant literature has not explained how to convert country-specific advantages (CSAs) in the local environment into FSAs. Drawing on the resource-based view of the firm, in this research we develop an overarching framework explaining how local firms in emerging markets first access CSAs, and then transform CSAs into unique FSAs. We thus shed light on central issues in the dynamic theory of strategy.

Keywords

Resource-based view; Country-specific advantages; Emerging markets
In the past few decades local firms in emerging markets have not only survived a fierce battle against established multinational enterprises (MNEs) for home markets, they have also expanded internationally through exports and foreign direct investment (FDI) to become multinational enterprises in their own right. High profile examples include China’s Huawei in telecommunications equipment, India’s Tata Consultancy Services in information technology services, Brazil’s Embraer in regional jets, Russia’s Gazprom in energy, and Mexico’s Cemex in cement. This evidence suggests that local firms have developed unique firm-specific advantages (FSAs) compared to established MNEs (Ramamurti, 2009; Williamson & Yin, 2009; Williamson & Zeng, 2009; Zeng & Williamson, 2007).

However, compared with established MNEs, local firms in emerging markets tend to possess technology that is less cutting-edge (Lall, 1983; Wells, 1983), resources that are less sophisticated (Bartlett & Ghoshal, 2000; Dawar & Frost, 1999), and disadvantageous branding among potential clients (Bilkey & Nes, 1982). Faced with this conundrum, the research question in this study therefore asks how local firms in emerging markets developed their unique FSAs compared to established MNEs.

CSAs (country-specific advantages) and FSAs have long been studied in the literature (Dunning, 1980, 1988; Dunning & Lundan, 2008; Hymer, 1976; Rugman, 1980; Rugman & Verbeke, 2003; Rugman, Verbeke, & Nguyen, 2011). CSAs are strengths or benefits specific to a country that result from its competitive environment, labour force, geographic location, government policies, etc. (Rugman & Collinson, 2009). FSAs are strengths or benefits specific to a firm that a result of contributions that can be made by its personnel, technology, and equipment (Rugman & Collinson, 2009). FSAs can be further categorized into location-bound (LB) FSAs and non-
location-bound (NLB) FSAs (Rugman & Verbeke, 1992, 2003). The LB FSAs reflect strengths deployable and exploitable in a limited geographic area, such as a single country or a limited set of countries and region, but cannot be profitably exploited outside of this area, whether as an intermediate output or embodied in final products. In contrast, NLB FSAs represent company strengths that can easily be transferred across locations at low cost, deployed and profitably exploited, with only limited need for resource recombination. Drawing on the resource-based view of the firm, Rugman, Verbeke and Nguyen (2011) suggest that CSAs in a country can lead to new LB FSAs but also have the potential to be transformed into NLB FSAs.

In a similar line, Porter (1991) examines the issue of a dynamic theory of strategy and indicates CSAs are the origins of FSAs by reviewing and analysing the progress of the strategy field. He separates the theory of strategy into two dimensions: the cross-sectional problem and the longitudinal problem. The first investigates the causes of superior performance at a given period in time, which can be termed as the cross-sectional problem. The framework of five competitive forces (Porter, 1980) falls in this category, which aims to build a careful link between the underlying choices a firm makes in terms of its industry, positioning, and market outcomes. Although this framework has been explored, contributed to, and tested by many other researchers (McGahan & Porter, 1997; Porter, 1980, 1985; Rumelt, 1991; Schmalensee, 1985) it has not answered the question why particular firms were able to get into advantaged positions and sustain or fail to sustain them. The answer to this question needs understanding of the so called longitudinal problem.

Scholars have also made some headway in answering the longitudinal problem. One prominent theory is the resource-based view (Amit & Schoemaker, 1993; Barney, 1986, 1991; Penrose, 1959; Wernerfelt, 1984), which argues that the origins of
competitive advantage are the valuable resources that a firm possesses, including technological know-how, management skills, reputation and the like. The promise of the resource-based view for the strategy field is the effort to address the longitudinal problem, or the conditions that allow firms to achieve and sustain favourable competitive positions over time. However, it still leaves unanswered the question about the origins of competitive advantage, which is: how can valuable resources be obtained, created, and sustained?

Drawing on those arguments, Porter (1991) goes further back in the chain of causality and contends that the origins of competitive advantage are the environment within which a firm is based. As stated by Porter (1991: 96-110), “We observe striking concentrations of successful firms in a particular industry in particular locations, which suggests that something about these locations are fundamental to creating and sustaining advantage…Instead of solely within the firm, the true origin of competitive advantage may be the proximate or local environment in which a firm is based”.

However, the extant literature has not answered the question of how CSAs in the local environment can be converted into FSAs. In this research we attempt to contribute a parsimonious and yet complete framework of CSA-FSA conversion towards a dynamic theory of strategy. We conclude with the observation that, given its pivotal position between country-specific advantages and firm-specific advantages, the CSA-FSA conversion process is likely to be a particularly fruitful focus for reinvigorating the study of how firms (in emerging markets) create and sustain competitive advantage.
THE CONCEPTS OF CSAS AND FSAS

As a starting point of understanding the concepts of CSAs and FSAs, we must go back to the theories developed by researchers in the area of FDI explaining international production and FDI (Dunning, 1980, 1988; Dunning & Lundan, 2008; Rugman, 1980, 1981; Rugman, 2010; Rugman et al., 2011). Dunning's eclectic or OLI paradigm explains that whether, and to what extent, a firm engages in FDI depends on three factors (Dunning, 1980, 1988).

The first is the ownership by the firm of assets or access to assets which its competitors or potential competitors do not possess. Such ownership-specific inputs may take the form of a legally protected right (such as patents, brand names, trademarks); or of a commercial monopoly (such as the acquisition of a particular raw material essential to the production of the product); or of exclusive control over particular market outlets; or they may arise from the size or technical characteristics of firms (such as economies of large-scale production and surplus entrepreneurial capacity).

The second is the interest and ability in the internalization of these assets, i.e. making use of them rather than selling or leasing them to others. The basic incentive of a firm to internalize its ownership endowments is to avoid market imperfections, which may arise wherever negotiation or transaction costs are high, wherever the economies of interdependent activities cannot be fully captured, and wherever information about the product or service being marketed is not readily available or is costly to acquire. It is argued that the common governance of geographically dispersed value-added activities within a single firm is comparatively more efficient and effective than governance by independent market actors or even by an equity joint venture where more than one firm is the residual claimant.

The third aspect is location-based factors that influence the profitability of
exploiting the firm's assets in a foreign country versus in the home country. These include not only Ricardian type endowments - natural resources, most kinds of labour, and proximity to markets, but also the legal and commercial environment in which the endowments are used, such as market structure and government legislation and policies. In classical and neoclassical trade theories, differences in the possession of these endowments between countries explain the willingness and the ability of enterprises to become international.

Rugman takes this approach further by combining the first two factors, ownership advantage and internalization advantage, into firm-specific advantage (FSA) and labelling the third factor country-specific advantage (CSA) in the FSA/CSA framework (Rugman, 1986; Rugman, 2010). However, the fit is not perfect. The main reason for misalignment is that Dunning's OLI model focuses upon outward FDI into host economies, whereas Rugman's matrix is for firm-level strategy covering MNE activity in both home and host countries (Rugman, 2010).

The original notions of the FSA/CSA concept can be traced further back to long before it was labelled as such. The underlying concept of CSAs developed more than 50 years ago, when national competitiveness at country level was the unit of analysis in IB research. In the pre-Hymer (1960) era, international economists dominated the field and focused on national competitiveness (i.e. CSAs) at the country level, using national statistics on trade and foreign investment. Their assumption is that differences in factor endowments across borders will lead to international transactions, whether transfers of capital or goods.

Hymer (1960) explains why a firm engages in international operations by shifting the focus from the country level to the firm level. He was the first to propose the concept of firm-specific advantages. Hymer's great insight is his recognition of the
MNE’s possession of FSAs, required to offset the liability of foreignness (LOF) when operating abroad (Hymer, 1976; Zaheer, 1995). FSAs are closely linked to the MNEs as the unit of analysis and more recently to the subsidiary of a MNE as a third major unit of analysis in IB research (Rugman et al., 2011).

Rugman and Verbeke (1992, 2001, 2003) have further argued that FSAs can be created anywhere in the MNE network, both in the parent company at home and in the foreign subsidiaries. FSAs can be location-bound or non-location-bound. The LB FSAs reflect strengths deployable and exploitable in a limited geographic area, such as a single country or a limited set of countries or region, but cannot be profitably exploited outside of this area, whether as an intermediate output (e.g., managerial skills, R&D knowledge) or embodied in final products. In contrast, NLB FSAs represent company strengths that can easily be transferred across locations at low cost, deployed and profitably exploited, with only limited need for resource recombination. Such NLB FSAs typically include the upstream patented technological knowledge, and the downstream brand names. This framework incorporates the thinking of Birkinshaw and Pedersen (2009) who align the resource-based view of the firm with the resources and capabilities developed and held in an MNE (Barney, 1991; Rugman et al., 2011; Wernerfelt, 1984).

THE RESOURCE-BASED VIEW OF THE FIRM

The idea of looking at firms as a broader set of resources goes back to the seminal book *The theory of the growth of the firm* (Penrose, 1959), which discussed the role of resources in diversification. However the resource-based view received relatively little formal attention in the following several decades, until Wernerfelt’s (1984) conceptual article entitled “A Resource-Based View of the Firm”, which was
selected as one of the most influential papers published in the *Strategic Management Journal* prior to 1990 (Wernerfelt, 1995). One major contribution of this article was to direct strategy scholars back toward resources as important antecedents of products and, ultimately, a firm’s performance (Priem & Butler, 2001).

The subsequent development of the resource-based view has focused on the characteristics of firm resources that can contribute to a sustainable competitive advantage (Barney, 1991; Dierickx & Cool, 1989; Rumelt, 1984). Dierickx and Cool (1989) suggested that managers should recognise that a bundle of firm assets lie at the heart of their firm’s competitive position. Barney (1991) provides what is arguably the most detailed and formalised depiction of the resource-based perspective, suggesting that organisational resources that are valuable, rare, imperfectly imitable and non-substitutable can yield sustained competitive advantage. Barney’s argument supplied the footing for many resource-based view studies, with subsequent work based on either his framework or an extension of it.

Barney (1991) notes that two assumptions are critical to the resource-based view of the firm: (1) resources are distributed heterogeneously across firms, and (2) these productive resources cannot be transferred from firm to firm without cost. These assumptions are the axioms of the resource-based view of the firm. Given the assumptions, Barney (1991) makes two fundamental arguments. First, resources that are both rare (i.e. not widely available) and valuable (i.e. contribute to firm efficiency) can lead to a competitive advantage. Secondly, resources which are neither easily replicable by competitors nor substitutable (i.e. when other resources cannot fulfil the same function), may lead to a long-term competitive advantage. From these core ideas, arguments have been advanced that firms can achieve sustainable competitive advantage from such resources as information technology (Mata, Fuerst, & Barney,
1995; Powell & Dent-Micallef, 1997), strategic planning (Michalisin, Smith, & Kline, 1997; Powell, 1992b), organisational alignment (Powell, 1992a), human resources management (Lado & Wilson, 1994; Wright & McGahan, 1992), trust (Barney & Hansen, 1994), organisational culture (Fiol, 1991; Oliver, 1997), administrative skills (Powell, 1993), top management skills (Castanias & Helfat, 1991), and guanxi (Tsang, 1998).

Following this stream of research in the resource-based view of the firm, we hope to find out whether CSAs in emerging markets can be rare, valuable, imperfectly imitable and non-substitutable resources which can lead to sustained FSAs.

**STRATEGIC CSAS IN EMERGING MARKETS ARE RARE, VALUABLE, IMPERFECTLY IMITABLE, AND NON-SUBSTITUTABLE RESOURCES**

As a starting point, we suggest that CSAs are valuable resources because they are fundamental to creating and sustaining competitive advantage (Porter, 1991). Six broad attributes of the proximate environment form Porter’s "national diamond" (Porter, 1990), each of which can influence the competitive advantages a local firm creates: ‘demand conditions’, ‘factor conditions’, ‘related and supporting industries’, ‘rivalries’, ‘the role of chance’, and ‘the role of government’. These will shape the information that firms have available to perceive opportunities, the pool of inputs, skills and knowledge they can draw on. The national diamond provides an effective and convenient way of classifying CSAs (Rugman & Collinson, 2009), and we will follow Porter’s classification for analytical purpose in this study.

Utilising this definition we next need to consider: what might make these potentially valuable CSAs rare, imperfectly imitable and non-substitutable (and hence “strategic”)? Of course, like internal firm resources, not all CSAs are rare and non-substitutable resources which can lead to sustained competitive advantage. In what
follows, we show how at least a percentage (often a large percentage) of the CSAs in emerging markets, meet those criteria and hence can contribute to the competitive advantage of some firms (rather than being freely and equally available to all firms in that location).

First, consider CSAs associated with local demand conditions. In order to access these CSAs, an effective distribution network is generally essential because the distribution network not only acts as a channel to bring goods and services to consumers, but also an important conduit for collecting information and insight about buyer behaviour. In many mature economies the distribution network is relatively easy to access because the market for distribution services is generally open and well developed. In these markets, for example, distribution can often be secured by contracting with any number of reliable local distribution agencies on transparent terms. In this case, the distribution network will not be a rare resource. In emerging markets, however, market imperfections mean that the distribution network is often difficult to access. As Hennart (2009) has pointed out, it can be a difficult and lengthy process for MNEs to build a distribution network in an emerging market because local customers may have formed strong bonds with a small number of powerful local distributors. Access to these distributors may be restricted and the terms non-transparent. Acquisition of these distributors may be blocked by host-country governments and, even where it is permitted, generally requires locally-specific, post-integration management skills. Building an alternative distribution channel, meanwhile, will also require a deep knowledge of local context, strong relationships with a myriad of local stakeholders and other location-specific capabilities. In this case, access to distribution networks in emerging markets will vary among competing firms, in turn rendering local demand conditions rare, imperfectly imitable and non-
Another CSA associated with demand conditions in emerging economies, especially China and India, are their large and rapidly growing domestic markets. In order to take advantage of this CSA, however, firms must be able to identify customers and secure their business (Hennart, 2012). This requires understanding their specific needs and tastes and hence location-specific capabilities to access the potential CSA. Moreover, in many emerging economies industries such as banking, telecommunications and car manufacture that are often considered as “nationally strategic” for development or security reasons, access to the market is often tightly controlled by national and local governments so that access depends on securing licences. The number of operating licenses is often very limited so that only those companies with the best relationships with the government or with superior negotiation skills attuned to local culture and norms are able to obtain them. These operating licenses are neither imitable nor substitutable. Again therefore, market access to those industries, and hence the potential CSAs associated with demand conditions, become a rare and strategic resource.

Second, in respect of local factor conditions, it has been widely assumed that factors such as abundant skilled but low-cost labour, are freely available to all entrants. In practice, however, accessing this labour pool requires capabilities for identifying, attracting, training and motivating suitable employees – capabilities that are often highly location-specific due to differences in local culture, career expectations, and institutions.

Third, effective access to CSAs associated with related industries and suppliers can depend on a firm designing their products and value chain to be compatible with local capacity, locally-specific relationship management and shared
culture -- especially in emerging economies where intermediate markets remain imperfect and the environment is characterised by significant institutional voids (Khanna & Palepu, 1997). The benefits of scarce access to these supply-side CSAs can be very significant with local suppliers offering adequate quality at 30% to 40% lower prices (Dobson, 1993).

The fourth dimension of Porter’s diamond, rivalry, is the attribute of the Diamond model that is most equally available to all firms because once in the same business environment all might be expected to face similar competition. Even here, however, interpreting the strategies and the implication of competitive moves and signalling by players in a particular market requires capabilities in local insight and analysis and knowledge networks, especially in emerging economies where the availability of reliable data and disclosure requirements are more limited than in mature economies.

The fifth dimension, the role of chance, includes developments such as the political decisions by government and surges in regional demand (Rugman & Collinson, 2009). Again, local knowledge and capabilities for assessing the implications, along with the quality of its local relationships, as well as regional presence and experience may impact a firm’s differential ability to take advantage of CSA’s thrown up by chance. The effects are likely to be particularly important in emerging economies where volatility is high and political processes less than transparent. When the Chinese government announced in September 2013, that it would create the China (Shanghai) Pilot Free Trade Zone within which financial services, telecoms services, professional services, shipping, entertainment, and social (education and medical) services would be deregulated, for example, about three dozen firms soon secured permission to enter. Yet weeks later it was still unclear how
they applied, since the rules had not been made public (The Economist, 2013). Clearly accessing this potentially important new “CSA” depended on reputation, relationships and capabilities that not all firms enjoyed.

Finally, institutional conditions in emerging markets are often difficult compared to developed countries. However, some local firms are capable to turn these disadvantages into advantages when competing with MNEs at home. The capability to cope with difficult institutional conditions at home may be useful in other emerging markets that also have difficult conditions and therefore present similar problems (Cuervo-Cazurra & Genc, 2008). Because only a limited number of firms can access and convert difficult institutional conditions into advantages, institutional conditions in emerging markets can be regarded as rare, imperfectly imitable and non-substitutable resources.

In sum, there are good reason to expect that, rather than being freely and fully accessible by all firms, a significant percentage of CSAs in emerging markets “strategic” in the sense that they are valuable, rare, imperfectly imitable and substitutable resources because they can only be accessed with the help of locally-specific capabilities, knowledge and relationships that are unequally distributed among different firms. The extant literature (e.g. Porter's national diamond, Dunning's OLI model, Rugman's FSA/CSA matrix), however, has not explained how strategic CSAs can be converted into new FSAs. This is the research question that we investigate in this study. In the next section, we will propose an overarching CSA-FSA conversion framework.

TOWARD A THEORY OF CONVERTING CSAS INTO FSAS

We have now explained that strategic CSAs in emerging markets are valuable resources which are fundamental to creating and sustaining competitive advantage. As
a starting point for converting FSAs from CSAs, firms must access strategic CSAs, as CSAs are external resources which exist in the business environment. Contrary to the implicit assumption of the OLI and internalisation theory, strategic CSAs in emerging markets are not equally available to all firms (Hennart 2009, 2012). In the following we will develop propositions to explain that some local firms in emerging markets are better able than established MNEs to access strategic CSAs because of their different competitive strategies, closer relationship with the government, and better local knowledge. Some local firms are also better at transforming those strategic CSAs into non-traditional FSAs because they have accessed complementary knowledge, focused on locally-appropriate innovation efforts, and achieved incentive alignment. Local firms may be endowed (at birth) with complementary capabilities of knowledge (e.g. from their founders) that help them access strategic CSAs and then transform them into new FSAs. Once the conversion cycle has started, more and more FSAs will be created by conversion from strategic CSAs. The conversion framework is shown in Figure 1, and we elaborate each proposition in more details as follows.

**Accessing CSAs**

*Competitive strategies.* Clearly there will be considerable inter-group variation in the strategies adopted by individual firms among MNEs and local firms competing in any particular market. Despite this variance, however, we can expect the modal points of these distributions to differ in systematic ways. Extant literature points to the trade-offs between global integration and local responsiveness as a key driver of MNEs strategies (Prahalad & Doz, 1987). This is because the ability to balance the benefits of internalising the transfer and arbitrage of common resources and capabilities against the costs of poorer fit with local market requirements lies at the
core of MNEs competitive advantage (Bartlett & Ghoshal, 2002; Devinney, Midgley, & Venaik, 2000; Prahalad & Doz, 1987). The strategic choices MNEs make will therefore impact the extent to which they seek to leverage the CSAs in a local market.

At one extreme, for MNEs adopting the global strategy and organisational model (Bartlett & Ghoshal, 1989), foreign subsidiaries will simply replicate their headquarters and compete in the local markets on the basis of FSAs transferred in from the headquarters. They do not develop additional FSAs adapting to the local business environments in host countries, and therefore those foreign subsidiaries lack the incentive to access CSAs in host countries. At the other extreme, even for MNEs adopting the multi-domestic strategy and organisation (Bartlett & Ghoshal, 2002) will focus more strongly on opportunities to access host-country CSAs. But their willingness to invest in accessing locally-specific FSAs will still be tempered, both by the costs and potential loss of perceived advantage associated with modifying their FSAs transferred from home and by the opportunity costs of host-country investment at the expense of investing in global or local activities at home.

Strategic choices by local firms, by contrast, are largely free of such trade-offs. Their home market will generally be their clear priority. Moreover, in seeking to build competitive advantage local firms will be strongly focused on the advantages of those available to them locally (CSAs) and especially those which can potentially provide differentiated advantages from those enjoyed by MNEs. These considerations lead us to the following proposition:

**Proposition 1:** Local firms will generally focus more resources on of accessing strategic CSAs at home than MNEs because differences in their competitive strategies.
Absorptive capacity. We may also expect local firms to have different levels of absorptive capacity in respect of local CSAs than MNEs. A firm's absorptive capacity is largely a function of the firm's level of prior related knowledge (Cohen & Levinthal, 1990). As we have noted above, a number of CSAs can only be accessed and exploited by deploying complementary local knowledge about: the local culture and business customs of a region; local consumer demands and tastes; expectations and behaviour of the local labour force, the strategies and structures of local distributors, suppliers and ancillary industries; the operation of local institutions; and other factors required for to conduct business in a region (Makino & Delios, 1996). Most of this knowledge is experiential and context-dependent (Doz, Santos, & Williamson, 2001). It so can only be amassed through the interactions among people with the programmes, operations or objects that are specific to a local context, such as a work practice in an organization (Yanow, 2004), often over an extended period of time. These forms of local knowledge and skills are also both location- and firm-specific in nature (Rugman & Verbeke, 1992). Because local firms and their staff have evolved their knowledge in their local environment (generally since birth), we would expect them to have more of this related prior knowledge than MNEs (even compared with MNEs with substantial experience in the host country). These considerations lead us to the following proposition:

Proposition 2: Local firms will generally have absorptive capacity more suited accessing CSAs at home than MNEs because they have amassed more experiential and context-dependent local knowledge.

Government and institutional relationships. As we noted above, government
policies may favour local firms over MNEs (Aggarval & Agmon, 1990), placing constraints on MNEs ability to access particular types of CSAs in a host country. In addition, imperfect markets and non-transparent and un-equal application and formulation of government policy may mean that certain CSAs can only be accessed in practice if a firm has complementary knowledge and relationships built up over a period of time. Likewise relationships may be essential to overcome institutional voids that must be bridged in order to access other local CSAs. These barriers are especially significant in emerging markets that are often characterised by highly imperfect markets, an inefficient judiciary, unpredictable and burdensome regulations, heavy bureaucracy, political instability or discontinuity in government policies (Ghemawat & Khanna, 1998; Khanna & Palepu, 1997). The absence of a well-established infrastructure, well-developed market mechanisms, and a well-developed contracting and intellectual property rights regime creates particular difficulties for MNEs from developed countries, which are not experienced in handling such conditions (Prahalad & Lieberthal, 1998). MNEs may acquire some of the necessary knowledge to access CSAs under these conditions, or accumulate it through long experience, but having evolved in this context, local firms will usually better able to deal with these institutional and infrastructure weaknesses (Cuervo-Cazurra & Genc, 2008; Morck, Yeung, & Zhao, 2008). These considerations lead us to posit that:

**Proposition 3:** Local firms will generally be capable than MNEs of accessing CSAs at home because they are better able to deal with weak institutions and have a closer relationship with government.

**Transforming CSAs into unique FSAs**

*Obtaining complementary knowledge.* Complementary knowledge obtained
from other firms plays important role in transforming CSAs into FSAs, when internal development is difficult or time consuming. Acquisitions and alliances are two ways that a firm can access resources owned by other firms (Das & Teng, 2000; Eisenhardt & Martin, 2000; Harrison, Hitt, Hoskisson, & Ireland, 2001). External sourcing modes such as acquisitions and alliances provide opportunities for obtaining distant resources and undertaking path-breaking change (Dussauge, Garrette, & Mitchell, 2000; Karim & Mitchell, 2000; Vermeulen & Barkema, 2001).

Acquisitions allow firms to extract value from under-utilised resources that firms possess, either through more efficient use of existing resources or through the creation of new resources (Karim & Mitchell, 2000). By merging, firms may pool similar resources for greater efficiency, so long as increased economies of scale outweigh the governance costs of acquisitions. In addition, acquisitions may allow firms to combine the routines that underlie different types of resources in order to create valuable new resources, again including government costs.

Alliances can help firms to gain market power (Hagedoorn, 1993), and move more quickly into new markets and technologies (Kogut, 1991). Alliances among businesses that possess complementary resources are often necessary for survival and growth, and provide a means of combining resources in order to exploit new business opportunities. Alliances appear to be an effective way of combining resources that are subject to a high degree of knowledge-based market failure (Gulati, 1998; Karim & Mitchell, 2000; Mitchell & Singh, 1993, 1996). Moreover, alliances provide a means for firms to protect the value of their resources through financial and organisational safeguards against opportunistic behaviour (Bresser, 1988; Hennart, 1988; Jorde & Teece, 1990; Kogut, 1988; Teece, 1986; Williamson, 1991).

There is a surge of outward FDI from emerging economies. By 2006, the
outward FDI stock of emerging economies exceeded $1,600 billion, compared to $149 billion in 1990 (UNCTAD, 2007). Many local firms' overseas expansion is "resource seeking", to learn and leverage resources and knowledge obtained from abroad (Bruche, 2009; Mathews, 2002). Local firms have also formed close alliances with leading MNEs to obtain complementary knowledge.

We need to emphasise that even after obtaining complementary knowledge, local firms often still do not possess better knowledge in general than MNEs. After all, the latter still have the most sophisticated technologies and proprietary knowledge. However, local firms often obtain more knowledge complementary to local strategic CSAs so that they are more capable of turning strategic CSAs accessed at home into unique FSAs. This is because local firms have more incentives to obtain related complementary knowledge to develop specific products and processes meeting the needs of local customers. While for MNEs, however, knowledge complementary to local strategic CSAs in host countries often does not fit with the knowledge transferred from their home countries, and therefore MNEs have less incentives to acquire locally complementary knowledge. This analysis leads us to posit that:

**Proposition 4**: Local firms are more capable than MNEs of transforming strategic CSAs accessed at home into non-traditional FSAs because they have obtained more complementary knowledge both abroad and domestically.

Locally-appropriate innovation efforts. The ability of firms to transform local CSAs into new FSAs is also strongly influenced by local innovation efforts. There is a rich supply of literature on the development and innovation process (Cohen & Levinthal, 1990; Kim, 1998; Kogut & Zander, 1992; Schumpeter, 1934; Szulanski,
As a starting point, firms often need to assimilate complementary knowledge. Assimilation here refers to the firm’s routines and processes that allow it to analyse, process, interpret, and understand the information obtained from external sources (Kim, 1998; Szulanski, 1996). Secondly, firms apply the assimilated complementary knowledge to the end products or services. Schumpeter (1934: 65-66) argued that, in general, innovations are new combinations of existing knowledge and incremental learning. The introduction of new products or processes - does not only mean pushing the frontiers of knowledge; rather, innovation can combinative and just new to the user. Promoting new uses of an existing technology by adapting it to serve local needs is often an innovation in itself (UNCTAD, 2005). For developing countries in particular, innovation is often aimed at creating locally appropriate technologies.

MNEs may differ strategically from local firms in their innovatory activities. Internalization (Buckley & Casson, 1976), or global integration of economic activity, reduces the MNE's need for undertaking innovatory activities at their affiliates. The largest drawback of internalization lies in the reduction of the deeper learning processes and spillovers in the host country. There is likely to be less effort to absorb, to adapt, to improve or to innovate technology in affiliates than would be the case when local firms obtain external knowledge and build upon the acquired technology (UNCTAD, 1999). On the whole, the literature suggests that major strategic decisions with regard to innovation are not usually delegated to the subsidiaries (Birkinshaw & Morrison, 1996; Birkinshaw, Morrison, & Hulland, 1995). Birkinshaw and Morrison (1996) found that there was a risk in having a product innovation mandate in the subsidiary, because it may be at variance with the corporate (parent) strategy.

For most established MNEs, the core R&D divisions are still located in their
home countries. Sometimes MNEs may invest heavily in R&D in emerging markets. However, often a large percentage of this investment exploits poorly paid scientists and engineers and develops products or services for the international market instead of targeting the specific needs of local customers in emerging markets. Conversely, local firms in emerging markets invest heavily in R&D to develop specific products and services which meet the distinct needs of local customers. They even overcome their latecomer disadvantage via a series of risk-taking measures by aggressively acquiring or buying critical R&D assets from mature MNEs to compensate for their competitive weaknesses (Luo & Tung, 2007). In other words, local firms focus more on locally appropriate innovation efforts than MNEs. This reasoning leads us to the following proposition:

**Proposition 5**: Local firms are more capable than MNEs of transforming strategic CSAs accessed at home into non-traditional FSAs because they focus more on locally appropriate innovation efforts.

**Achieving incentive alignment.** Agency theory (Fama & Jensen, 1983; Jensen & Meckling, 1976; Keeley, 1980) has long emphasised that the separation of ownership from control creates problems with alignment of interests, particularly to do with management compensation and the allocation of corporate perquisites. Abuse of discretion and the use of corporate assets for private purposes can occur without appropriate oversight. These issues become more severe as an enterprise internationalises and the separation between ownership and management widens (Roth, 1996). In the global industry context, three factors are critical in influencing goal incongruence and information asymmetries, thereby determining the potential
agency problem within the headquarters-foreign subsidiary relationship. The first factor is cultural distance, determined by the degree to which there are differences between the cultural characteristics common to the headquarters’ market and those of the market of the foreign subsidiary (Erez & Earley, 1993). With increased cultural distance, complete and accurate information about agents' performance becomes more difficult and expensive to attain. The second factor that increases the agency problem in the headquarters-foreign subsidiary relationship concerns the strategic and operational role of the foreign subsidiary. It is expected that the specialised knowledge and managerial discretion associated with foreign subsidiaries results in information asymmetries that increase the agency problem in the headquarters-foreign subsidiary relationship (Rajagopalan & Finkelstein, 1992). The third factor concerns commitment or psychological alignment at the individual level. Foreign subsidiary managers' values or identification may vary in the degree to which they are attached to a principal problem. As the parent commitment of the foreign subsidiary manager decreases, goal conflict between the manager and headquarters will increase.

Because of these difficulties arising from the management of subsidiary managers, profitability is often used as the key measure by headquarters to evaluate their performance. However this kind of governance is not suited to creating additional FSAs from the raw material of CSAs in the host country, as subsidiary managers are under huge pressure to achieve short term profitability. For example, subsidiary managers would rather invest in marketing and sales divisions (such as hiring more sales personnel) which have immediate positive effects on profitability than the R&D facilities and capability (which is critical in transforming local CSAs into new FSAs) which can have negative short term effect on profitability.

In contrast, local firms do not have the agency problem in the headquarters-
foreign subsidiary relationship. The owners of some local firms are still working as the CEOs. Therefore these local firms will be better positioned to achieve incentive alignment between owners and managers, and therefore more likely to invest in local R&D and other long term investment (such as building accommodation and offering it to their employees at low cost) to achieve long term goals, which helps local firms to transform raw CSAs into new FSAs. Also, with the development of capital markets in developing countries, many local firms are listed firms which are now closely monitored by the public. They also have established effective practices of corporate governance such as offering stock options to their key employees to achieve incentive alignment (which MNEs find difficult to match) and inviting independent board members from outside to monitor the performance of senior executives. This analysis leads to the following hypothesis:

**Proposition 6:** Local firms are more capable than MNEs of transforming strategic CSAs accessed at home into non-traditional FSAs because they are better positioned to achieve incentive alignment between owners and managers.

In summary, some local firms are more capable of accessing strategic CSAs at home that MNEs find difficult to access, and are also more capable of transforming them into unique FSAs. Strategic CSAs in emerging markets include skilled but low-cost labour, an extensive distribution network, demand by a particular market, and close relationship with government. This set of CSAs accessed by local firms is different from the set of CSAs accessed by MNEs in their home countries. Because CSAs are the origins of FSAs, from the different vector of CSAs accessed at home local firms are likely to develop unique and non-traditional FSAs. Examples of those
non-traditional FSAs include cost innovation capability, the ability to unlock latent demand in low-end segments, optimisation of products and processes for emerging markets, the ability to deal with weak institutions and infrastructures, or the ability to optimise value chains globally in ways that allow low-cost talent and resources to be leveraged effectively in emerging markets.

It is worth noting that the results (FSAs) of the conversion process can in turn change the nature and content of CSAs. Human resources, which is a factor condition, may enhance skills and competitiveness through work experience with employers. Knowledge and proprietary technologies developed by firms may spillover to their alliances and suppliers, consequently improving the competitiveness of local industry clusters. New competitive advantages developed by a firm may pose a threat to its competitors and therefore spur them to innovate and upgrade. Indeed, CSAs and FSAs coexist in the same ecosystem and it is their dynamic interaction that underpins the economic development of a nation.

**CONCLUSION**

We have now developed the conversion framework with 6 propositions systematically explaining the process of converting CSAs into FSAs. We suggest that strategic CSAs in emerging markets can be valuable, rare, imperfectly imitable and non-substitutable resources that can lead to unique and sustained FSAs. Contrary to the implicit assumption of the OLI and internalisation theory, strategic CSAs in emerging markets are not equally available to all firms operating in the same location. We argue that some local firms in emerging markets are more capable of accessing strategic CSAs at home because of their different competitive strategies, better local knowledge, and close relationship with the government. Some local firms are also more capable of transforming strategic CSAs accessed at home into new FSAs
because they have obtained complementary knowledge, focused on locally-appropriate innovation efforts to produce specific products and services to meet the specific needs of local customers, and achieved incentive alignment to facilitate the conversion process. On the contrary, established MNEs often do not make enough complementary investments in emerging markets to transform local strategic CSAs into new FSAs.

Our research findings have a number of important theoretical contributions. In the first instance, we argue that CSAs are not equally available to all firms and local firms are able to access CSAs better than MNEs, which is a significant departure from the view that CSAs are equally available to all firms (Dunning, 1980, 1988; Rugman, 1980, 1981). Furthermore, the extant literature has not explained why local firms in emerging markets are able to access CSAs better than MNEs at home. We argue that local firms in emerging markets are more capable of accessing strategic CSAs than MNEs because local firms have different competitive strategies, a closer relationship with local government, and better local knowledge.

Secondly, our research findings also bear on the heated debate about whether local firms in emerging markets have developed unique FSAs compared to established MNEs (Ramamurti, 2012). On the surface, local firms in emerging markets seem to lack the technology, branding and management advantages of established MNEs, as they only have “ordinary resources” which traditionally have not been considered to be the source of extraordinary rent (Madhok & Keyhani, 2012). We suggest that strategic CSAs accessed by local firms are not ordinary resources in the sense that some local firms are more likely than MNEs to access strategic CSAs at home because of their different competitive strategies; some local firms are more able than MNEs to access strategic CSAs at home because they are better able to deal with
weak institutions and have a closer relationship with government; and some local firms are more capable than MNEs of accessing strategic CSAs at home because they have better local knowledge. For these reasons, they can underpin the creation of unique and non-traditional FSAs compared to established MNEs.

Thirdly, we take a first step towards developing testable propositions in an endeavour to construct a dynamic theory of converting CSAs into FSAs. Traditionally CSAs (Porter, 1990; Shan & Hamilton, 1991) and FSAs (Barney, 1991; Porter, 1985) are studied in two separate paths in the literature. Although many scholars have indicated that the origins of FSAs are CSAs (Dunning, 1980; Porter, 1991; Williamson & Yin, 2009), how CSAs can be converted into FSAs is not well understood. The conversion framework developed in our study contributes to a new understanding of the underlying processes of converting CSAs into FSAs. We must also note that FSAs developed by firms through the conversion processes can in turn change the nature and content of CSAs, and their dynamic interaction in the same ecosystem underpins the economic development of a nation.

Finally, we also contribute to the RBV theory by extending the boundary of valuable resources from internal firm resources alone to include external resources. The resource-based view of the firm focuses on the value of internal firm resources (Wernerfelt, 1984), and has not considered that external resources may also lead to sustained competitive advantage (Priem & Butler, 2001). However, a large percentage of CSAs in emerging markets are in fact valuable and rare resources because of the imperfect factor markets, underdeveloped institutions, and among other reasons. The conversion framework therefore extends the RBV theory by suggesting strategic CSAs are valuable and rare resources in the context of emerging markets.

Our study also has some interesting implications for practitioners. The first
implication is that established multinationals should pay more attention to accessing CSAs in host countries. However, MNEs face a dilemma of internalizing proprietary technologies and accessing local CSAs by cooperating with local firms. On the one hand, MNEs often encounter serious difficulties in accessing CSAs such as distribution skills and understanding specific customer demands in a host country, a process which calls for cooperation with local firms. On the other hand, leading multinationals emphasise the protection of proprietary technologies by internalisation, which prevents them from forming close strategic alliances with local firms. How to balance internalizing proprietary technologies and accessing local CSAs by cooperating with local firms is a task which established multinationals must confront and is also essential to success in host countries.

The second implication is that in some circumstances accessing strategic CSAs is even more difficult than accessing technological knowledge. Accessing distribution network in a host country is often a challenge and the inability of MNEs to do so has often hampered their entry and jeopardised their survival (Hennart, 2009); the practice of preferential purchasing, which locks foreign firms out of government contracts, may not change as quite as easily (Zaheer & Mosakowski, 1997). On the other hand, with the globalisation of the world economy, it is now easier for firms from emerging markets to access technologies and know-how through new gateways opening up in the form of: outsourcing, modularisation, codification of knowledge, and creating more open markets for international talent and corporate control (Williamson & Yin, 2009).

The third implication is that for established MNEs, willingness to invest in emerging markets is not sufficient to transform strategic CSAs in emerging markets into new FSAs. The investment must be complementary to local strategic CSAs if
they are to take advantage of them. However, most MNEs tend to make investments that are driven by their existing business models rather than complementary to local strategic CSAs. Again, taking the example of R&D investment, many MNEs have established large scale R&D centres in emerging markets. However, often the R&D centres in emerging markets try to exploit the low-paid skilled engineers and focus on developing products for the global market rather than the local market.
FIGURE 1
The Conversion Framework

Competitive strategies

Institutions, government relationship

Accessing complementary knowledge

Locally-appropriate innovation efforts

Country-specific advantages

Firm resources (Strategic CSAs)

Firm-specific advantages

Local knowledge

Achieving incentive alignment
REFERENCES


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