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The Rise of the Indian Multinational Corporations and the Development of Firm-Specific Capabilities

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Abstract

Several scholars have strived to explain the rise of emerging MNCs (EMNCs), but a satisfactory understanding of the firm-specific causative factors is still missing. In this paper, we seek to fill this gap in the literature. Since the 1990s, India, like most other emerging markets, has experienced dramatic transformation of her competitive and institutional environment. These transformations have been a catalyst for the rise of Indian multinational corporations (MNCs). We discuss the macro context of the rise of the Indian MNCs during the pre and post reform periods. Then, we analyze the micro foundations of the rise of the Indian MNCs in terms of the development of specialized firm-specific capabilities in the both periods. Finally, we discuss how the profile of the country and firm-specific ownership advantages has evolved, and supported the rise of the Indian MNCs.

Keywords

emerging multinational corporations, outward foreign direct investment, globalization, India, emerging markets, ownership advantages

1. Introduction

Over the two decades, there has been a rapid rise of MNCs from the emerging markets. Several scholars have sought to explain this rise. Taking a view that EMNCs lack firm-specific ownership advantages, a first explanation of the EMNCs is exploitation of home country comparative advantages, such as cheap labor or natural resources (Rugman 2007). Ramamurti criticized the emphasis on country-specific advantages for explaining Indian EMNCs, and conjectured that such an emphasis might have held true “Five or ten years ago.” (Ramamurti, 2012: 42). Since the 1990s, India, like most other emerging markets, has experienced dramatic transformation of her competitive and institutional environment. These transformations have resulted in the rise of MNCs from India also. While a large number of Indian firms have invested overseas, a few – who are all family businesses – account for the

majority of overseas investments and acquisitions. In India, only a few firms, the firms that were both large as well as family-owned, have historically led and dominated outward FDI. This has remained true even in recent times, when acquisitions have become a dominant mode of outward FDI. During 2000–2006, for instance, 15 large business houses were responsible for 98 out of 306 overseas acquisitions, accounting for over 80 percent of the total value of acquisitions (FICCI 2006). Thus, even if the exploitation of home country comparative advantages characterized some of the Indian FDI in the past, the question remains what capabilities distinguish the firms that pursued FDI and overseas acquisitions versus others who did not.

A second explanation of the EMNCs is the springboard theory (Luo & Tung, 2007), according to which the EMNCs invest abroad in order to acquire ownership advantages. But even this explanation fails to address why EMNCs do not need ownership advantages to successfully internationalize, while the MNCs from the industrialized nations typically do as shown by the empirical studies of OLI theory (Ramamurti, 2012).

A third explanation of the EMNCs is their deep capability for organizing and managing value chains appropriate to the emerging market contexts, and in linking these with the global value chains. Ramamurti (2012) proposes that the EMNCs have a different set of ownership advantages, other than established brands and intellectual properties, such as their deep knowledge of the customers of the emerging markets, and ability to design, produce, and market affordable, low cost, no-frills products, while operating in difficult business environments. Others have noted how constrained and spurred by the government policies and directives, Indian EMNCs focused on reengineering Western know-how to suit relative factor prices in India ("technological comparative advantage," -Diaz-Alejandro, 1977); including the ability to use domestic skilled labor to design and operate projects at low cost, and to lower the costs of technical personnel and management. They excelled in the entrepreneurial adaptation of original designs to local conditions of the developing nations such as nonavailability or prohibitive costs of raw materials, peculiarities of local consumers, the climate and geography (Athukorala, 2009). Ramamurti (2012) contends just as low cost operating capability is a strong ownership advantage for WalMart, it is also so for the EMNCs. Others hold low cost operating capability might be a weak form of ownership advantage in the context of EMNCs (Madhok & Keyhani, 2012), and might not sufficiently and uniquely distinguish emerging market firms who successfully internationalize vs. those who don't.

A fourth explanation of the EMNCs is the market reforms theory (Rugman, 2007). According to this, once the emerging market governments undertake internal market reforms and open their home market to inward FDI, the foreign firms are able to transfer their technological and organizational know-how and network linkages, and the local MNCs emerge by absorbing these into firm-specific advantages. However, this explanation fails to explain the emergence of Indian MNCs in the pre-reform period, and contradicts the time-tested absorptive capacity theory (Cohen & Levinthal, 1990). If the industrial

market firms needed prior firm-specific advantages in order to even recognize external know-how and advantages, then how could the emerging market firms do so sans prior ownership advantage?

The question of what forms the ownership advantage of the EMNCs remains open. We suggest the following explanation for the Indian context: during the pre-reform period, the successful Indian MNCs were able to use the capability to exploit country-specific advantages for internationalization because they also developed specialized firm-specific advantages. We propose that most firms in India's emerging market did not do so, because the institutional incentives during that period promoted rent-seeking behavior based on the scarcity of country-specific advantages. For instance, most firms lacked access to raw materials, labor, and capital, and those who had preferential access to these resources typically were able to generate rents primarily because of these country-specific advantages.

Our first proposition is that in the pre-reform period, the early success of some Indian firms in outward FDI, as compared to the firms who failed to make such FDI successful, may be attributed to the inter-firm differentials in the strategic pursuits to exploit country-specific advantages for firm's internationalization, and in making investments in firm-specific capabilities to support this strategic pursuit.

We further propose that as Indian firms became large, and their ability to access additional country-specific resources was constrained, because of the government's concerns about monopolistic concentration of power. Many began developing specialized firm-specific advantages as a way to cope with the scarcity of country-specific advantages. A few larger family business houses developed additional organizational capabilities to leverage country and firm-specific advantages across diverse, quasi-autonomous business units. They were able to internationalize based on these advantages and organizational capabilities. When the market liberalized and controls removed, the capacity of all the firms to compete locally based on the access to the country-specific advantages waned. Many more firms began developing organizational capabilities around their specialized firm-specific advantages, and using them as the absorptive capacity for learning new know-how both domestically (from the foreign investors and other indigenous sources) and globally. That has accelerated the pace of their internationalization and of progression to higher-commitment and more complex operating modes, such as mergers and acquisitions.

Therefore, our second proposition is that in the post-reform period, comparative success of many Indian firms in FDI may be attributed to the inter-firm differentials in applying firm-specific capabilities for absorbing, leveraging, and augmenting both indigenous as well as international management know-how. The firms who have engaged in this application have been able to develop ownership advantages, and pursue locational selection, governance, and organizational strategies in more complex forms.

While the emphasis of the general literature on the MNCs is on having ownership, locational and internalization advantages (as in the eclectic theory), we contend that in the context of the emerging

markets, the early focus ought to be more on the strategic pursuits that help develop firm-specific capabilities in exploiting available and feasible country-specific advantages. Once these country-anchored firm-specific capabilities are developed, the firms can then apply them for integrating and enhancing both indigenous as well as international know-how. Thus, they can develop distinctive and unique firm-specific advantages in an accelerated manner, and with only limited resources, and compete with the well-established industrialized market firms and MNCs. That is, the successful emerging market MNCs develop organizational mechanisms to connect with a much broader base of exogenous advantages, as they are less encumbered by the need to protect and exploit only their firm-specific ownership advantages. Using their organizational capability, they creatively link their limited firm-specific resources and advantages with the external resources and opportunities, and rapidly propel forward and carve unique niches in the competitive global markets.

In this paper, we first review literature on MNCs, and how the research on the emerging MNCs challenges, and further develop this literature. We explore the role of specialized firm-specific capabilities in pre and post reform macro environment in India. We deconstruct specialized firm-specific capabilities that helped Indian MNCs successfully internationalize.

2. Literature Review

In the eclectic paradigm (Dunning, 1977; 1997) it is contended that MNCs have competitive or 'ownership' advantages vis-à-vis their major rivals, which they utilize in those countries that are attractive due to their 'locational' advantages. MNCs retain control over their networks of resources and capabilities (productive, commercial, financial and so forth) because of the 'internalization' advantages of doing so. Internalization advantages arise when a MNC is able to appropriate a full return on its ownership of distinctive assets. In addition, the firm may coordinate the use of complementary assets that are under the common governance of a network of value-chain activities located in different countries.

In the eclectic model, ownership advantages are essential to the MNC outward FDI. On the other hand, the international expansion allows firms to accumulate and improve such “ownership” advantages, through sourcing and developing ‘firm-specific’ advantages in the countries in which the production activities are sited. All MNCs, including the industrial leaders as well as the nascent ones, need to establish certain ownership advantages in order to start the globalization “circle”.

The OLI model has been largely used in explaining the strategic decisions of the MNCs, such as location choices, competition and mode of international expansions. Most previous studies have focused on the large MNCs that originate from the developed countries (Anderson and Cantwell, 1996; Narula, 1999; Cantwell and Narula, 2003, 2001), and developed countries are considered traditional sources of the outward FDI. However, in recent years, FDI from the emerging and developing economies such as China, India, South Africa and Latin America to both developed and developing

economies has dramatically increased. At this point, whether and how can the eclectic model fit remains an interesting question in the International Business field.

The research on the EMNCs can help extend the OLI model. Specifically, there may be a complementary relationship between the firm-specific and the country-specific advantages, that may be particularly salient in the early stages of a country's internationalization. As an emerging market nation develops several international links, its MNCs may also assimilate and absorb knowledge that is found in the host countries, and consequently develop more complex and hybrid forms of capabilities.

We first discuss the macro context of the rise of the Indian MNCs, and then analyze the micro foundations of the firm-specific capabilities using the value chain framework.

3. Context: Changes in Macro Environment and the Rise of the Indian MNCs

We categorize two phases in the development of the Indian economy – pre-1991 and post-1991. Prior to 1991, the Indian business houses faced a very restrictive policy environment for the domestic growth. Based on interviews conducted in 1982 with 17 parent companies, Lall (1986) found the desire to escape the constraining effects of government policy, especially the Antitrust Act, as the most important motivation behind overseas investment. At the time, there were severe restrictions on the overseas FDI. The business houses had to make FDI at minimum foreign exchange costs, i.e. using minority ownership in foreign joint ventures, and this ownership share was primarily in the form of export of machinery and know-how. The policy envisioned these FDI initiatives as supporting partnerships with other developing countries and the non-aligned movement policies (Jonsson, 2008).

In 1991, India shifted its policy focus to liberalization and globalization of the economy, and allowed the raising of capital for expansion. The shift moved the Indian economy from a GDP growth trajectory of 3-4 percent annually to 6-9 percent annually. The new policy conceived transnational initiatives as key to the development of a globally competitive "India Inc", particularly through the alliances with the industrialized nations (Government of India 2009). There was a rapid expansion in Indian FDI after 1991, and then again in 2005, when the government allowed firms to float holding companies in offshore tax-free financial centers to finance acquisitions abroad facilitating the use of leveraged buy-outs. Since then, holding arms in offshore financial centers, such as Mauritius, Singapore and the Netherlands, are primary channels to mobilize funds and invest in third countries (Khan, 2012).

Phase 1-- Until 1991: Local developmentoutposts

At the time of independence in 1947, many large Indian business houses had entrepreneurial and technical capabilities built over many decades. Although the British colonial rule had initially hindered their development, yet they revived under the market changes brought forth by the Great Depression. Beginning with traditional products such as sugar and paper, they diversified into entirely new areas such as textile machinery (Birla), domestic airlines (Tata), shipping (Walchand Hirachand), and sewing machines (Shriram). In 1945, India was the tenth largest producer of manufactured goods in the world

(Tomlinson 1993).

After independence, the public policy of India used licensing policy to strictly regulate and restrict production capacity and access to capital for the large business houses within India; but supported development cooperation with other developing nations through transfer of technology and capital goods using collaborative joint venture projects (Pradhan & Sauvant, 2010). The policy also supported export promotion to the industrialized nations, with a view to earn valuable foreign exchange. Thus, Birla Group invested in a textile factory in Ethiopia in 1959, and Tata Group in 1961a wholly-owned trading subsidiary in Switzerland. Other business groups like Thapar, JK Singhania, Mafatlal, and Godrej followed (Pradhan & Sauvant, 2010: 5). Dunning's OLI theory framework can offer deeper insights into the behavior of FDI by large Indian business houses in the pre-1991 era.

Ownership factors: During the pre-reform period, the Indian business groups faced a slow growing domestic market, along with restrictive licensing and antitrust regulations, which limited their ability and incentives to invest in indigenous capabilities. Though the institutional regime was inward-looking, import substituting, and constrained scale, it did encourage indigenous advantages in absorbing, assimilating, adapting, and reverse engineering foreign technologies, to make them appropriate to local demand and factor conditions (Ramamuri, 2012). The early investors exploited these technological advantages by leveraging them in culturally, administratively, geographically, and economically (CAGE) similar markets found in other developing nations. During the 1960s, there were only six Indian foreign investors, and these belonged to five large business houses – Thapar, JK Singhania, Birla, Godrej, and Shriram. When the MNCs show a propensity to invest in the CAGE similar markets, it is usually indicative of tacit firm-specific advantages (Lo, Mahony & Tan, 2011). Such firm-specific advantages and knowledge are difficult to transfer to the CAGE distant societies, and therefore the firms seek to build their organizational capability to codify their specialized, tacit knowledge by first investing in the CAGE similar markets. In such instances, the firms tend to invest only in a handful of overseas subsidiaries (Lo, Mahony & Tan, 2011).

Locational factors: Before 1990s, a key inspiration for a restrictive FDI policy in India was a belief that the FDI should not operate in a manner similar to how developed region FDI operates in the developing nation, but instead should be an effective means to share India's development experience with fellow developing nations. The developing nations also had a favorable policy attitude towards FDI projects originating in other developing nations. The profile of various developing regions evolved over time. During 1961-69, Africa accounted for 60 percent of the Indian FDI to developing nations; while Asia accounted for the other 40 percent (Pradhan, 2008). All were manufacturing ventures seeking to tap local markets. The industrialization programs of the newly independent nations, colonial era historical business links, and presence of India-origin population in both regions were the major pull factors. During the 1970s, African nations introduced restrictive policies for inwards FDI, and suffered political violence and internal strife. Asian nations offered stable political conditions, improving market health,

and foreign investment friendly regimes. Therefore, by 1980-89, Africa accounted for 22 percent of the Indian FDI to developing nations, while Asia accounted for more than 50 percent. The Indian MNCs also targeted additional geographies in Latin America and Eastern Europe (Pradhan, 2008).Thus, over time, there was a sequential broadening of the target geographies, and the political challenges faced in the CAGE similar region of Africa appear to have played at least some role in promoting this broadening. The ability of the Indian MNCs to successfully target additional geographies points to their tacit firm-specific know-how.

Internalization factors: The government restricted the access to foreign exchange, and allowed foreign direct investments only in the form of the exports of Indian-made machinery and Indian know-how. Capital limitation influenced the mode of entry: joint ventures with overseas partners, who could provide local networks and resources, were favored. The share of joint ventures in the total number of outward FDI projects rose, from 62% in the 1960s to 70% in the 1980s. In the developed nations, however, a majority of their outward FDI projects were in the form of whollyowned subsidiaries. Over 1961-2007, the wholly owned subsidiaries constituted 76% of India's outward FDI projects within developed regions. The Indian business houses were able to compete independently in the industrialized nations by investing primarily in trading, consulting and engineering services domain, which required limited capital and stronger coordination with the home market (Sauvant & Pradhan, 2010). In the emerging markets, Indian business houses invested primarily in manufacturing ventures. They funded their share of equity through the transfer of technical knowledge, while the foreign joint venture partner offered funds for establishing local production and secured host market access (Sauvant & Pradhan, 2010).

Thus, for overseas trading and services, as well as manufacturing, activities, the Indian MNCs relied on tacit knowledge and coordinated their overseas activities in both the industrialized as well as the emerging markets through strong links with the home operations. Further, since their home operations were based on the local country-specific advantage, the Indian MNCs were likely to use a multi-domestic strategy and rely on local country-specific advantages in their overseas operations as well (Lo, Mahony & Tan, 2011). The localized networks, such as strategic links with the local vendors, tend to augment the tactic knowledge base of the MNCs, as compared to the global networks that tend to encourage growth in the codified body of knowledge (Bartlett & Ghoshal, 1989).

Overall, the profile of ownership, location, and internalization advantages of the Indian MNCs during the pre-reform period points to the presence of specialized tacit firm-specific knowledge. They utilized this knowledge primarily for investing into the development outposts in the other emerging markets. Localized networks for tapping the country-specific advantages in these markets likely contributed to growth over time in the specialized tacit knowledge of these firms. Similarly, it is likely that the localized home networks of the Indian firms that chose not to internationalize also contributed to growth over time in the specialized tacit knowledge of those firms, as well. Next, we examine the

pattern of FDI by this latter group of firms in the post-reform period.

Phase 2 – Post 1991: Becoming Global Players

By the early 1980s, the Government of India was beginning to recognize the folly of prioritizing on the public sector for industrialization. There were growing efforts to entrust the task of technology management to the private sector. It was difficult for the private sector to succeed in the hardware sector without a reliable supply base for high-quality low-cost parts and components. Opportunity space, however, emerged in software. Many firms set up US offices that served the client's maintenance, basic programming and testing needs onsite, and later began taking higher value-added contracts offshore to India. The government invited western MNCs to form joint ventures focused on technical collaborations with Indian firms. In the early 1990s, the policy liberalization of both inward as well outward FDI helped Indian firms transform from an inward orientation to an outward orientation. The growing domestic market, and enhanced liquidity and access to foreign capital, led many business houses to upgrade technologies and compete on a global scale. They sought to develop and acquire new knowledge bases, and to bring maturity in their accumulated processes in order to facilitate rapid and cost-effective replication and scaling. Additionally, they began linking and leveraging learning opportunities across their international network of ventures, as a springboard to a stronger transnational profile. This had an impact on their ownership, location, as well as internalization decisions.

Ownership decisions: The liberalized policy environment for overseas investments and acquisitions allowed large Indian business houses to innovate cost-effective processes, to conduct R&D-based product development, and to pursue quality and skill improvement. They were also able to augment, reconfigure and reposition their dispersed networks of capabilities, to support entrepreneurial venturing at a global scale. A liberal regime for the inward foreign investment, initial demand from the public sector, and an excellent home skill-base, together aided the rise of a new generation of professionally-run business houses. Using professional hires, scientific methods, and information technology, these firms began codifying, systemizing, and maturing the previously tacit firm-specific advantages in areas like process design, marketing and branding (Jonsson, 2008).

Locational decisions: As the capabilities of the business houses matured, the developed nations became an attractive FDI destination. The share of the developed regions in Indian FDI rose from 20+ percent in 1980s to 40+ percent in 1990s, and to 60+ percent in the 2000s. The developed nations also offered an opportunity to acquire new sets of capabilities, technologies, and know-how that were relevant for competing and succeeding in the global markets. In the 2000s, about 83% of the value of overseas acquisitions by Indian business houses was in the industrialized markets, and only 17% was in the emerging markets (Sauvant & Pradhan, 2010). 37 percent of the developed market acquisitions were in the UK, and 39 percent in the USA. Oswal (2010) found that the Indian firms who gave greater importance to North America tended to have higher foreign sales to total sales ratios, as compared to

those who gave greater importance to Asia. The developed nations were particularly attractive for the service-oriented business houses, especially software and information technology services, who emerged as the fastest growing investors during the 1990s and 2000s (Pradhan, 2008). Still manufacturing constituted 79% of acquisitions over 2000s, which mainly reflected large-sized acquisitions done by Indian companies from steel industry and related to relatively small value acquisitions by firms from other industries such as food processing, electrical machinery, chemicals, pharmaceuticals and non-electrical machinery.

The emerging markets also remained important. In fact, the overall Indian FDI to the emerging markets was $1.9 billion in the 1990s, but increased to $8.8 billion over 2000-2007. Overall, Asia hosted about 39 percent of Indian FDI flows, followed by Africa with 34 percent, Eastern Europe with 15 percent, and Latin America with 13 percent. Indian MNCs invested in the emerging markets both to exploit their technological advantages, as well as to access additional country-specific advantages to support their operations in the industrialized markets. Younger standalone firms were more likely to invest in the emerging markets to exploit their technological advantages, while the older business houses were more likely to seek access to additional country-specific advantages in these markets for their global strategies. Athukorala (2009: 134) notes, "Indian MNCs [primarily standalones] that operate abroad in order to exploit their local technological advantages set up plants predominantly in developing economies. In contrast, firms [primarily business houses that] target developed economies…also invest in other emerging economies, not so much to serve these markets as to broaden the number of low-cost countries from which they can serve rich country markets."

Interestingly, the business houses most active in making the FDI were not the ones who led the FDI charts during the pre-reform period, but others who previously focused more on the domestic market (Pradhan, 2008). Economic liberalization reduced the possibility of rent-seeking from the control of the home-country resources, and forced the inward-oriented business houses to be more innovative in searching for the lower-cost resources. These business houses had accumulated specialized firm-specific capabilities for qualifying and deploying lower-cost resources for meeting the needs of the customers without compromising on the quality. They now extended these capabilities to qualify lower-cost resources from the other emerging markets as well, and to serve the needs of the customers in the industrial markets as well.

Internalization decisions. Until the 1990s, Indian firms invested overseas using only the greenfield route, but since 2004, their investments have been primarily through acquisitions. During 2005– 2008, the value of total acquisitions amounted to $22 billion, about 80 percent of India's total reported FDI outflows. 68 percent of acquisitions by Indian firms during 2000–2006 involved acquisition of full ownership; acquiring minority ownership occurred only in less than 15 percent of cases. Most of the large acquisitions in industrialized nations involved full ownership. Indian MNCs used minority ownership largely only for the acquisitions in developing and transitional economies (FICCI, 2006).

Overall, the share of wholly-owned subsidiaries in the total number of outward FDI projects of Indian firms rose from 30% in the 1980s, to 54% in the 1990s and 70% in the 2000s (Pradham & Sauvant, 2010). The surge in the share of wholly owned subsidiaries in the total number of outward FDI projects was notable in the technology-intensive manufacturing activities like machinery and equipment, electrical machinery, pharmaceuticals, transport equipment, and chemicals (Sauvant & Pradhan, 2010). Indian business houses acquired Western firms in order to access new products, gain marketing, distribution, and after-sales service channels, and to secure new technology and other intangible skills. Even in the emerging markets, their focus shifted from the host market access, to serving the global market and acquiring natural resources like oil, gas, and minerals, while protecting their existing firm-specific advantages (Sauvant & Pradhan, 2010).

Thus, in the emerging markets, Indian MNCs have continued to rely substantially on the local networks, resulting in what Lo et al (2011) refer to as “environmental embeddedness”. The advantages based on the environmental embeddedness are operated in coordination with suppliers and other local partners, local factors of production such as manpower and materials, and local environment such as infrastructure, laws and regulations. These advantages require the MNCs to create responsiveness to local environment by offering more autonomy and sharing more control with the local partners (Lo et al, 2011). The demands for local responsiveness make codification more challenging, and support more tacit solutions based on the specialized and tacit knowledge.

On the other hand, in the industrialized markets, Indian MNCs are evolving global strategies that involve greater organizational coordination. They seek to connect the value chains vertically with the supply base situated in the emerging markets. They also seek to serve both the differentiated value chain for the premium customer segments of the industrial markets, as well as the affordable value chain for the more limited purchasing power customer segments within India and the other emerging markets.

In other words, Indian business houses have moved rapidly to not only further strengthen the local responsiveness skills from their operations and alliances in the emerging markets, but also to develop the global integration skills by putting priorities on acquiring the established businesses and taking total control of their operations in the industrialized markets. The fusion of these two skills in their global value chains indicates a nascent development of the higher-order transnational capabilities among the Indian business houses within a very short period since the reforms.

4. Discussions

4.1 Development of the Firm-Specific Advantages of the Indian MNCs

What was the nature of specialized firm-specific advantages of the Indian MNCs during the pre and post reform periods? Using the concept of value chain, we examine the role of manufacturing, marketing and trading capabilities, as well as the organizational capabilities.

Manufacturing capability: In the pre-reform period, Indian firms lacked access to capital. However, they had access to local engineering talent. Additionally, Indian firms developed a capability for frugal designing using workarounds termed jugaad, based on a mix of imperfect resources traded from diverse sources and over diverse periods. Many Indian firms modified baseline large-scale technologies from abroad to use less capital, and complemented the exploitation of frugal redesigned technologies with the country-specific labor cost advantage. In mid-tech industries, redesigning capital investment using specialized firm-specific advantage yielded 30-40 percent 'capex' advantage, and lower wages and overheads emanating from the country-specific advantage offered a comparable 'opex' advantage over the Western MNCs (Ramamurti, 2008). Both these advantages together made them one of the world's lowest-cost producers in chemicals, pharmaceuticals, transport equipment and machinery and equipment. In the prereform period, Indian manufacturing FDI was concentrated in such knowledge-intensive sectors, and not in the labor and material-intensive sectors that rely predominantly on the country-specific advantages (Lall, 1983). Since the specialized firm-specific advantages of the Indian firms required stronger environmental embeddedness for complementary access to the local country-specific advantages, Indian manufacturing FDI was mostly for locally producing and marketing the products in host nations. These FDI projects were a source of intermediate technologies appropriate to the needs and development capacities of the host developing nations.

In the post-reform period, the erstwhile domestically focused Indian business houses sought to offer these cost-effective intermediate technological inputs to the MNCs in the high-wage nations, and used advanced frugal product design skills to offer the cost-effective technological solutions as well. For instance, Dr. Reddy's developed a strong skill in alternative chemical synthesis, to reverse engineer patented drugs in a way that difficult-to-manufacture bulk drugs could be made and marketed globally using less capital and using local labor. It honed its cost and quality control processes by establishing the largest number of US FDA-certified manufacturing plants of any country outside the USA (Gupta, 2006). Similarly, Tata Group developed the Nono car to retail for $2000, and Mahindra & Mahindra invested under $150 million to develop the Scorpio SUV to retail in the US for under $25,000, significantly less than the rival products.

Some firms established a presence close to the high-income customers in order to transition towards greater value-adding product solutions. For instance, United Phosphorous group transformed itself from a domestic insecticide player to a global generic agrochemicals player, by acquiring several European companies that gave it a foothold in the mature industrialized markets dominated by giants like Dow Chemicals and Dupont (Gupta, 2006). Other firms invested in various emerging markets as well to augment their capacity to offer cost-effective technological inputs to the industrial markets, when adequate complementary country-specific advantages were not available within India. They entered other emerging markets, such as East and Southeast Asia, to establish a diversified supply base for servicing customers in high-wage nations. This "dual shoring" strategy combined their

manufacturing and vendor base in emerging markets with a presence in key Western markets.

Marketing capability: In the pre-reform period, Indian firms lacked access to the demand with high purchasing power, but had access to the demand based on value for money. That meant a demand for demonstrable solutions that were designed to be affordable, rugged and easy to maintain in the harsher conditions found in emerging markets (Rugman, 2010), such as unreliable power, weak intellectual property regimes, and other institutional voids (Khanna & Palepu, 2005). Indian MNCs linked their frugal designing capability with demonstrable solutions appropriate to the needs of the emerging market customers. The essence of their marketing capability lay in combining the affordable process re-engineering skills with world-class process management skills. Unlike process reengineering that is an element of the manufacturing capability, process management is an element of the marketing capability that seeks to use the knowledge, skills, tools, techniques and systems to define, visualize, measure, control, report and improve processes with a goal to meet customer requirements profitably. While the process reengineering skills were complemented with the local environmental embeddedness, the process management skills were honed through global embeddedness – alliances with the world-class players and hiring top-class engineer-managers. For instance, Asian Paints, now a top ten decorative paint companies in the world, had a strategy of entering fast growing emerging markets with robust demand and low per capita consumption of paints. First, it formed joint ventures with the existing players, and later, it pursued acquisitions, such as of Berger International, to establish manufacturing presence in more than 20 nations, serving the growing markets of Asia, Africa, and the Caribbean (Gupta, 2006). Similarly, the pharma business houses increased their R&D to sales ratio from near zero in pre-1990 era to 9 percent in 2000s, and created upgraded technologies involving intensive automation of the operational process. With a stronger emphasis on globalization, competitiveness, and development, the willingness of the large Indian business houses to share ownership waned. Yet, they also recognized the benefits of local environmental embeddedness. As such, they continued to support the development of locally appropriate technology in other emerging markets. This occurred through their subcontracting relationships with the small and mid-sized Indian business houses investing in the same markets, and with the local vendors. Local connections offered a window to simpler, more diffused, more undifferentiated, labor-intensive technologies, enabling the Indian MNCs to sustain their frugal designing capability.

Trading capability: In the post-reform period, access to capital was liberalized. New demand based on the greater purchasing power emerged. Many standalone firms and business houses wooed foreign investors. Bhaumik et al (2010) find that equity linkages with foreign investors generate costly-to-produce intelligence about overseas markets, enhance the quality of family firms' corporate governance and ease access to external finance, and are a crucial resource for family firms to facilitate outward FDI. The larger business houses used their superior credit ratings to access global capital and to takeover foreign plants in the maturing segments of the mid-technology industries, such as cement,

steel, aluminum, auto parts, personal computers and beverages. These plants of the Western firms were technologically obsolete, under-sized, and experiencing diminishing returns (Ramamurti, 2008). Local environmental embeddedness in the emerging markets helped Indian MNCs give a new life to the acquired units – both by trading in more cost-effective inputs as well as by trading out outputs on a larger scale. As noted earlier, trading-in was rooted in their manufacturing capability, and trading-out in their marketing capability. Market liberalization was at the root of unleashing this trading potential, by empowering the Indian firms to participate in the global capital and investment markets. Many firms, such as Moser Baer in optical media, Bharat Forge in auto components, Reliance in polyester yarn, Arvind Mills in denim fabric, and Zee Telefilms in satellite television channels, became global category leaders (Gupta, 2006).

Organizational Capability: Successful transnational journey is contingent on the capability to cope with the heterogeneous institutional, cultural and competitive environments (Ricks, Toyne and Martinez, 1990), to coordinate geographically dispersed resources (Roth, 1995), and to leverage resources across national borders (Bartlett and Ghoshal, 1989). The Indian firms who introduced process and human resource changes for globalization enjoyed strongest internationalization performance (Oswal, 2010). These firms evolved a team of talented executives with international experience, and gave them the autonomy to take decisions in diverse markets (Oswal, 2010). Dabur group for instance runs its international operations through Dubai-based subsidiary, Dabur International, which oversees all global activities and manufacturing subsidiaries in various nations. The successful MNCs also integrated their information system processes and shared information worldwide (Oswal, 2010). The core of the organizational capability of the Indian MNCs was their ability to manage cultural, institutional, geographical, and market diversities. The size and the diversity of the Indian market honed this capability.

In the post-reform period, intensified global competition led the large business houses to find synergies for focused integration. These synergizing capabilities became an impetus for their developing signature expertise in post-merger integration, as they relied more on the acquisitions for international expansion (Jonsson, 2008). Still because of the specialized nature of the firm-specific advantages, the large business houses engaged in the overseas FDI activity with respect to only a few of their affiliates. Using firm-level FDI data for pharma and auto sector in India for 2000-2006, Bhaumik, Driffield, & Pal (2010) find that in aggregate, family firms – especially those affiliated to business houses – have a lower proportion of their assets overseas, than the non-family firms. While family subsidiaries in fact dominate the overseas FDI of India, most family affiliates operate only in domestic markets, because they have yet to develop the specialized firm-specific advantages needed to compete in the global markets.

In summary, the basis for the manufacturing capability of the Indian MNCs was the frugal designing / process reengineering skills for finding creative and cost-effective workarounds (referred to as *jugaad*).

This manufacturing capability involved tacit know-how, and was a major source of competitive advantage. The basis for the marketing capability was the worldclass process management, which bestowed credibility and authenticity of quality and enabled access to customers in both the emerging as well as the industrial markets. This marketing capability was organizationally embedded, and facilitated the design of global strategies. The basis for the trading capability was the local environmental embeddedness, and was executed through multidomestic strategies. This trading capability complemented their frugal designing skills by providing access to various local country-specific advantages, including local workforce, vendors, know-how, and varied geography, culture and institutions. The basis for the organizational capability was the diversity integration skills, which helped Indian MNCs to work seamlessly across cultural, administrative, geography, and economic diversities.

4.2 The Changing Nature of "O"wnership Advantages in EMNCs:

In this section, we discuss the change of a few attributes in the history of Indian MNCs and how these are related to the OLI model.

a. The sources of "ownership" advantages: home country → host countries and regions.

The knowledge-based view suggested that the efficient exploitation of MNCs' ownership advantages and the continual need to augment and sustain such advantages is crucial, and leads to a complex interdependence between ownership and location advantages (Dunning, 1998; Kogut and Zander, 1993). The location choice of Indian MNCs matters not only because it shows the changing pattern of Indian MNCs' international entry, but because that the locations serve as the "sources" of knowledge base on which the firm-specific advantages build upon (Cantwell and Narula, 2001; Cantwell, et al., 2001).

It is notable that the behavior of the Indian MNCs mirrored that of the Japanese MNCs, who also started their overseas expansion from developing countries, such as SE Asia, but shifted to industrialized countries like Europe and U.S in more recent years. Previous research has shown Japanese MNCs' initial location choice was due to the constraints of manufacturing resources in their domestic market (Kojima, 1975, 1973). Japanese MNCs needed to seek less-expensive resources in proximate locations, and their early OFDI was mainly an export-platform type. But the motivations for the Indian MNC investments in SE Asia and Africa were somewhat different.

In the pre-reform stage, most of the FDI flows were from overseas into India, as opposed to being from India to outside. Indian MNCs absorbed and accumulated technological advantages through both reengineering of the foreign know-how as well as frugal innovations in the home country, and leveraged them to the suitable markets - other developing countries. Thus, both firm-specific and country-specific advantages supported their development. In the post-reform period, many Indian MNCs are seeking alternative opportunities in technologically more advanced countries. As in the Japanese case, the shift of FDI destinations indicates both the complexity of the firm-specific

advantages necessary to compete in the advanced markets, as well as the opportunities for learning some more advanced know-how. Note that unless these Indian firms already have capabilities to absorb the complex know-how in the industrialized markets, they are unlikely to be successful in doing so just because they chose to make a financial investment to go into the industrialized markets.

Furthermore, ownership advantages also progressively interact with internalization advantages (the international coordination), and such interaction allows both advantages increase alongside one another. The outward FDI of EMNCs tends to follow an evolutionary pattern. As the firms that relied primarily on ethnocentric advantages become more mature, they move beyond investment in a single activity or in some locations that are independent from the others, to adopt a more polycentric perspective. At this point, the character of their ownership advantages becomes hybridized involving the local know-how and the firm's home base and acquired know-how. The establishment of EMNCs' internalization capabilities to allocate resources and coordinate activities on a global base makes these Indian MNCs truly "transnational" rather than just "polycentric".

b. The nature of ownership advantages: simple, substitutable → collective, sustainable

The shifted source of the EMNCs' ownership advantages leads to the changing nature of these firm-specific advantages. According to Dunning (1997), two types of "O" advantage can be distinguished: the ownership of particular unique intangible assets, and the development of capabilities. While ownership advantages enabling early FDI into the emerging markets involved a simpler and easy to substitute character (such as exporting machinery and know-how), the ownership advantages in the later stage of development when the Indian MNCs moved to developed economies reflect a more complex and character. The knowledge-based approach suggests that the complex, collective type of ownership advantages are more sustainable, and include the overall organizational abilities, such as R&D and marketing, the experience and entrepreneurial capabilities of its managers taken together, its political contacts and its long-term business agreements with other firms (Madhok and Phene, 2001). Such collective firm-specific ownership advantages tie up with internalization advantages in the internationalization process, and the internalization advantages to manage learning, sourcing, and marketing operations in distant locations become a source of MNC's competitive advantages over indigenous firms in the relevant local markets (Guisinger, 2001).

Thus, we challenge the competing argument identified in the introduction of this paper, that historically the internationalization of Indian MNCs was driven simply by country-specific advantages. We suggest that early Indian firms, before jumped to the international market, already gained some firm-specific advantages that were built upon the unique ways in which each of the firms approached country-specific resources and policy benefits. Some firms used these advantages as a basis for expanding into certain foreign markets, particularly under situations where they found it more difficult than did their local counterparts to find opportunities in the constrained local environment. Their success, albeit limited in scope, gave confidence to their peers as well that the Indian firms, despite the

limited internationalization and development of the home country, are capable of competing in the global markets using their own advantages, and using collective learning and knowledge acquisition mechanisms. Thus, initial foreign built-ups by select Indian MNCs helped start the "virtuous circle", encouraging Indian MNCs in the post-reform period to continuously and rapidly improve and upgrade the "O" advantages through connectivity with diverse "Locations" and "Internalizing" within the firm international supply-chain.

The activities involved in the outward FDI by Indian MNCs follow some evolutionary patterns, that are potentially generalizable. Beginning from exploiting existing resources and country-specific advantages from the home country, EMNCs' involvement has shifted towards gradually more diverse and collective types of production and service or some integrative forms of advanced value chain activities, such as connecting both design and branding. Those Indian MNCs (such as standalone MNCs) who haven't accumulated sufficient firm-specific advantages, tend to choose the entries with minimum costs and risks, such as exporting or minority ownership joint ventures situated primarily in the developing nations.

Based on the above discussion, Table 1 provides a comparative overview of the development of Indian MNCs in the pre and post-reform period.

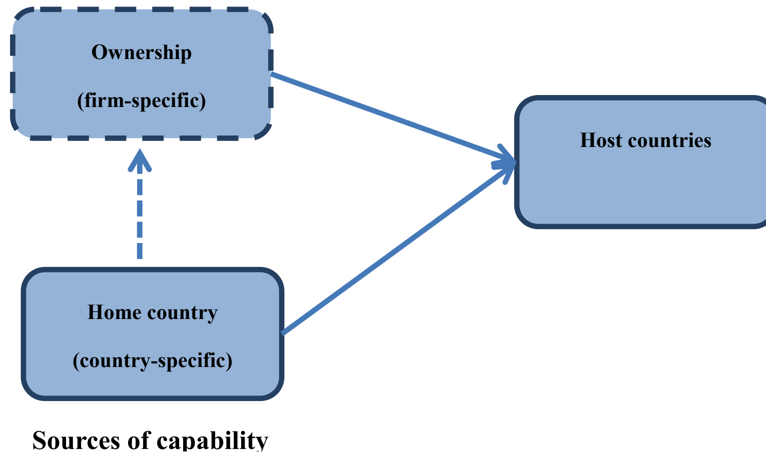
Table 1. Comparison of macro and OLI factors in the development of Indian MNCs

	Pre-reform period	Post-reform period
Macro factors		
FDI Orientation	Inward FDI	Outward FDI
Driving forces	Institutional factors	Market competition
OLI factors		
"**O**"wnership		
Source of O	Home country	Host countries
Nature of O	Simple & substitutive	Complex & sustainable
"**L**"ocation		
Location	Developing countries	Developed countries
"**I**"nternalization		
Entry mode	Exporting and J.V	Acquisition (wholly-owned subs)
Activity	Standalone value chain activities	Integrative value chain activities
MNCs	International	Transnational

Figure 1 shows that in the pre-reform period, the source of MNC capability was the linkages between the firm-specific ownership advantages and home country advantages. The home-country enabled frugal innovations, while the firm-specific advantages enabled effective organization of these frugal innovations, including through linkages with the reengineering opportunities. In the post-reform period, the MNCs went beyond exploiting the linkages with the home country advantages, but also sought to build linkages with the host country advantages. They saw such global linkages crucial for their success

and sustainability not just as an MNC, but also as key players in the domestic market which was being increasingly liberalized and opened to global competition.

Pre-reform period



Post-reform period

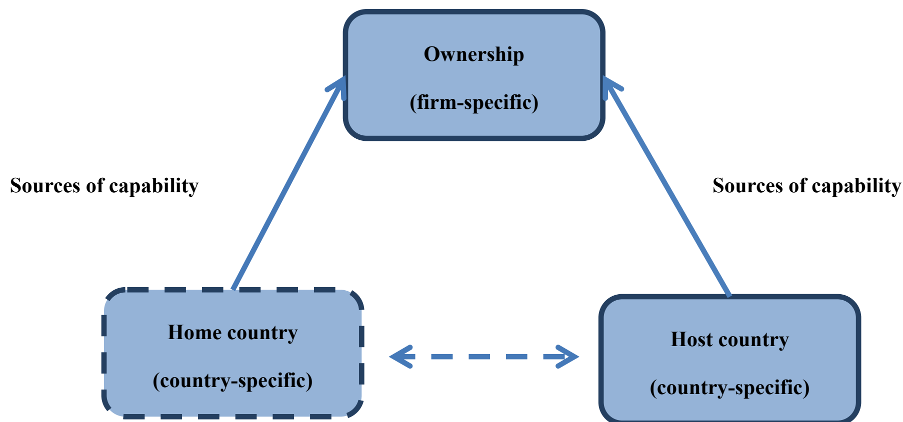


Figure 1. The sources of ownership advantages in pre-reform and post-reform periods

5. Conclusions

Though constrained and shepherded by the policy environment, most Indian business groups historically developed tacit firm-specific manufacturing capabilities for frugal reengineering of the global know-how during the pre-reform period. They also developed trading capabilities for accessing country-specific advantages, such as local talent, vendors, and materials, within the context of India. During the pre-reform period, some business houses extended their manufacturing and trading capabilities for overseas FDI in other emerging markets. But most were satisfied with the rent-generating opportunities offered by the preferential access to country-specific advantages in India.

Both these groups operated within the context of an institutional policy framework that in general discouraged overseas FDI, but offered some encouragement for the FDI that contributed to the development of the other emerging markets. Specifically, there was an institutional desire to support the development of other emerging markets, by offering a socially sustainable model of foreign direct investments: based on the transfer of know-how and capital goods, on forming collaborative joint ventures with the host partners, and serving local country-specific needs to enable a vision of import-substitution and self-reliance. This desire lay largely hidden within the context of a policy that was otherwise rather inward looking, and thus most firms did not consider overseas FDI as a viable option.

In the post-reform period, the institutional choice shifted towards global integration. Previously domestically focused business houses had a rich history of accumulating firm-specific advantages, and in fact led many segments of the domestic market. They augmented their process reengineering skills with world-class process management skills, through hiring of the top engineer-managers and consultants, and collaborations with the Western firms. They also augmented their home country trading networks by investing in other emerging markets, in order to be able to access a larger scale and more diverse set of country-specific resources, with which to cement their unique manufacturing power. These extended trading networks deepened their overall competitive advantage, by making them less vulnerable to competition from Chinese and other firms who had superior access to lower-cost country-specific advantages. They also created new trading networks in the western markets, both to acquire capital from the foreign investors, as well as to acquire under-performing assets from the Western firms. They then offered superior returns to the foreign investors and superior performance and rewards to the foreign stakeholders of these Western assets. Thus, they helped extend the social and economic impact of Indian FDI activity from the emerging markets to all around the world.

A major factor in the rapid transnationalization of Indian MNCs appears to be their organizational capability, specifically the capability to seamlessly integrate teams and serve clients across diverse cultural, administrative, geographical, and economic boundaries. This capability may explain the success of the Indian firms as global offshore as well as onshore centers in the software, information technology enabled services, and various other service areas. We contend that this organizational capability is oriented towards enabling the Indian MNCs to link, connect, and embed their firm-specific capabilities with a broad base of exogenous capabilities – both indigenous as well as international. The Indian MNCs lack the large and deep base of firm-specific resources and advantages of the type that the more established and affluent MNCs from the industrialized markets have. Their organizational capability, however, allows them to forge focused and specialized links with a range of exogenous resources, and provides them with the speed, dexterity, flexibility, and adaptability required to recognize and seize opportunities in the global market, and to withstand competition from their better endogenously endowed MNC counterparts from the industrial markets.

It is also notable that most Indian firms have limited or no participation in the overseas FDI, and several others – including many of the early internationalizes – continue to rely primarily on joint ventures and on the other emerging markets. This might reflect challenges in the development of appropriate organizational capabilities for supporting a focused networking of the exogenous resources and capabilities. Future research may examine in further depth the differences in the capabilities and the FDI behavior of the MNCs in India and in the other emerging markets.

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