

## CHAPTER 1

# Introduction

### 1.1. Foreign direct investment and its performance

The decision of a company to allocate a significant amount of firm resources to entering a foreign market is a strategic step which has crucial consequences for the long-term competitiveness of a firm. Foreign direct investment (FDI) is the most complex and also the most challenging mode of engaging in cross-border operations [Bamberger & Wrona 2012]. FDI, its motives, modes and location choice have been key themes in international business research [Canabal & White 2008; Tahir & Larimo 2006; Werner 2002]. However, there is nothing inevitable about the success of foreign expansion, since unexpected and unfavourable changes in the external environment can result in withdrawal from international markets and a re-focus on activities in the home market, which can be reflected by divestments undertaken by multinational enterprises, or MNEs [Trąpczyński 2013b]. Therefore, the maximisation of performance of international operations is an important concern for MNE managers, and it is also an integral component of various theories of foreign direct investment [Glaum & Oesterle 2007].<sup>1</sup>

Despite the relevance of the topic, extant empirical studies on the influence of internationalisation on firm performance still point to a rather ambiguous and unclear relationship. Firm-specific resources have long been accentuated as relevant determinants of foreign expansion of the firm in many theoretical concepts, including the theory of monopolistic advantage [Hymer 1976], internalisation theory [Rugman & Verbeke 2008], or the eclectic approach [Dunning 1988a, 1998;

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<sup>1</sup> In fact, economic sciences deal with the allocation of scarce resources between alternative uses, thus they are inherently related to the concept of performance [Robbins 2007].

Dunning & Lundan 2008a,b). From the perspective of these approaches, resources can accordingly be regarded as a necessary condition of foreign expansion. And yet, the effect of different resources on performance, such as firm size, product differentiation, international experience and host-country experience has remained ambiguous [see e.g. Delios & Beamish 2001; Luo 1999a]. In fact, an excessive reliance on experience might hinder the learning effects in foreign markets and cause organisational inertia [Delios 2011; Dow & Larimo 2011; Wu & Lin 2010]. Moreover, international experience is not necessarily market-specific, thus its applicability to foreign contexts might be restricted [Carlsson, Nordegren & Sjöholm 2005; Guillen & Garcia-Canal 2009].

At the level of host countries, FDI-related theoretical concepts have provided a broad set of location determinants of FDI, affecting host-country choice [Brouthers et al. 2009; Dunning 1998], FDI mode choice [Slangen & Hennart 2007, 2008] and performance [Brouthers, Brouthers & Werner 2003]. In particular, the analysis of the institutional environment provides an important set of variables which influence the ease of doing business, particularly in emerging markets [Ma, Tong & Fitza 2013; Meyer & Peng 2005]. Some previous studies have underlined that the quality of the business environment is an important determinant of productivity of firms embedded in it and hence a key location choice determinant [Dunning 2005]. Accordingly, an underdeveloped institutional framework can have a negative influence on the level of FDI activity in a given country [Globerman & Shapiro 1999; Wei 2000]. Therefore, the effect of different institutional environments on the performance outcomes of foreign affiliates is a crucial research issue.

Moreover, while the success of foreign expansion has long been subject of the research stream linking firm multinationality to its performance, its conceptual underpinnings and research design make it impossible to determine the contribution of specific FDI projects to overall MNE performance, as well as its antecedents. On the other hand, research devoted to foreign affiliate performance has remained confined to antecedents of economic outcomes at the level of the foreign market. Linking these two perspectives is of both theoretical and practical relevance. Meanwhile, few studies on the influence of MNE strategy on foreign affiliate performance have identified relationships between FDI motives, which can determine the role of the affiliate within the corporate portfolio, as well as affect its actual performance outcomes. Notably, market-seeking motivations were found to be more related to local market sales than other location advantages [Demirbag, Tatoglu & Glaister 2007].<sup>2</sup> While in business reality a foreign affiliate can fulfil

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<sup>2</sup> A similar contingency could be observed for resource-seeking investments and labour cost reduction [Chan, Isobe & Makino 2008; Li et al. 2011; Uhlenbruck 1997].

a bundle of different objectives from the perspective of the MNE the specific dimension on which an affiliate can be expected to display superior performance appears to be contingent on the mandate of the affiliate within the MNE portfolio. While this relationship might appear to be trivial, the practice of business operations shows that not all FDI projects fulfil their initial objectives, frequently resulting in reductions of foreign activities [Benito & Welch 2007].

## 1.2. The context of emerging markets in international business research

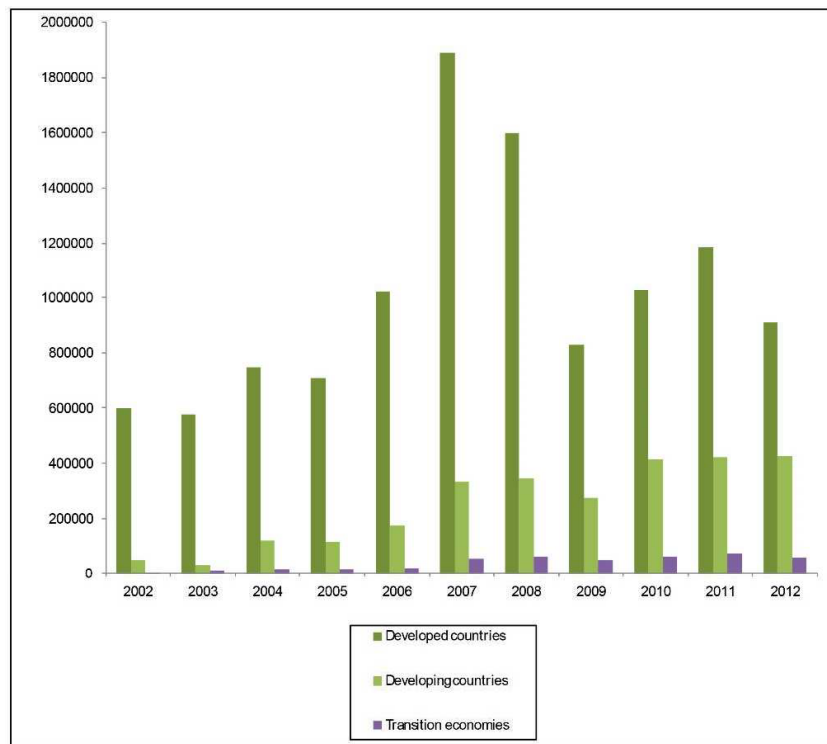
As Sauvant [2008] notes, outward FDI from emerging markets does not actually represent a novel phenomenon. Indeed, the so called emerging MNEs (EMNEs) already started their international operations as early as in the 1970s [Dunning, Kim & Park 2008]. However, more striking is the increasing growth of this phenomenon, which has rapidly accelerated in the 2000s, considerably faster than the expansion of developed country MNEs (Graph 1).

These firms' internationalisation patterns have raised the question as to the ability of extant international business theory to explain the investment motives, resource endowments, location choices, entry modes [Jormanainen & Koveshnikov 2012; Hennart 2012]. Firm-level studies on outward FDI from Central and Eastern European (CEE) countries<sup>3</sup>, including those from Poland, have remained scarce and have usually neglected FDI performance implications. At the same time, the analysis of FDI performance of firms from a post-communist can provide interesting contributions to international business research. There are opposing views as to the character of their firm-specific advantages. Firms from this category of countries are latecomers to international markets and hence display disadvantages in terms of their international competitiveness. Svetličič et al.'s [2000] study indicates that FDI by Slovenian firms arose as a result of the lack of ownership advantages and the intention to enhance international competitiveness via FDI. On the other hand, outward investors frequently competing in more advanced economies do require technological advantages, marketing or organisational know-how [Svetličič & Jaklič 2003]. In fact, market-seeking motives still clearly prevail among Polish outward FDI [Gorynia et al. 2013a; Jaworek et al. 2009; Radło 2012]. Accordingly, while being laggards to global economy, firms from emerging markets must inevitably rely on certain firm-specific resources, which allow them to successfully compete, especially in economically more advanced

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<sup>3</sup> For the purpose of the present analyses, CEE countries include new EU members (EU-13), as well as former Soviet republics in Europe.

countries [Pierścionek & Jurek-Stępień 2006; Rosati & Wiliński 2003; Szałucka 2009; Śliwinski 2011].



**Graph 1.** FDI outflows 2002–2012 by countries of origin (in millions USD)

Source: own work based on UNCTAD [2005, 2006, 2007, 2013].

Furthermore, in the context of economic transition in Central and Eastern Europe, the gradual internationalisation behaviour can be interpreted as exploitation of earlier business ties. Gorynia et al. [2014a] found that the experience with doing business in the CEE region, was perceived by the managers of the investigated companies as a key advantage in capital expansion in the host economies. The impact of host-country characteristics on the success of firm internationalisation deserves attention in the context of the CEE region, since its historical heritage has shaped the institutional environments. In countries with weaker institutions, where market-based advantages tend to be less crucial and where firm performance is highly volatile, the ability to cope with turbulent institutional envi-

ronments due to home-country advantages can be of high importance [Cuervo-Cazurra & Genc 2008; Del Sol & Kogan 2007; Henisz 2003; Makino, Isobe & Chan 2004]. Thus, it can be argued that affiliate performance of MNEs from an emerging market in similar or institutionally less developed settings should increase with a decreasing stability of the institutional framework.

### 1.3. Objectives of the volume

In line with the relevant research questions pertaining both to firm internationalisation by means of foreign direct investment and its performance outcomes, as well as the specific context of internationalisation of MNEs originating from emerging markets, the main objectives of the present volume can be summarised under the following key points:

- review of theoretical concepts pertaining to foreign direct investment at the level of the firm, providing explanations of foreign expansion and its performance consequences (Chapter 2);
- review of literature on MNE strategies, with a particular focus on the determinants of FDI performance and clarification of the notion of FDI (Chapter 3);
- review of extant research on multinationals from emerging markets, including Poland, (Chapter 4);
- presentation of empirical findings of a study of foreign outward investors from Poland, with specific focus on FDI strategies, location patterns, firm characteristics, foreign affiliate performance, as well as the contribution of an affiliate to the investing firm's performance (Chapter 4);
- discussion of implications for business practice and economic policy (Chapter 5).

In order to achieve these goals, the book draws on the most widespread theoretical firm-level concepts pertaining to FDI and sets a conceptual foundation for the empirical study. Moreover, the volume subsequently draws on concepts of MNE competitiveness in order to discuss crucial aspects of MNE strategy and performance antecedents in more depth. In addition, the context of emerging market MNEs, with a particular focus on those stemming from Poland, is also included in the conceptual chapters of the book in order to underline their salient features and the resulting peculiar research problems.

The empirical study, which is based on quantitative data from a survey of 100 Polish outward investors, complemented by qualitative data based on in-depth interviews with 6 Polish outward investors, is based on the analytical framework<sup>4</sup>

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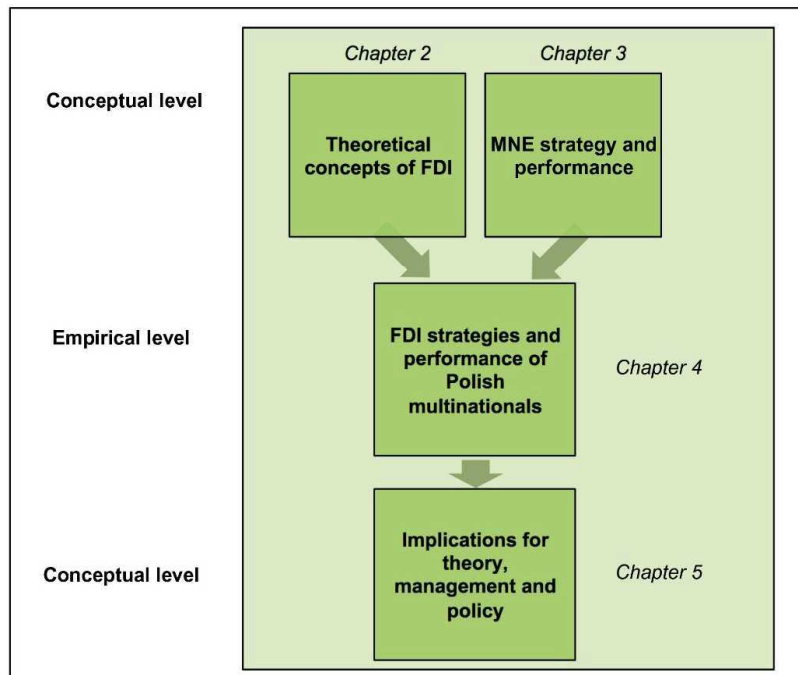
<sup>4</sup> See Section 4.3.1.1.

devised on the basis of the said theoretical foundations. In accordance with the research objectives, a multiple host-country design has been adopted. The information was collected from Polish firms investing abroad, defined as companies registered and located in Poland, holding at least 10% equity in a foreign entity. A structured online survey was administered to companies by using a sophisticated survey system allowing for constant progress monitoring. In order to increase the reliability and validity of the study, the findings obtained from the quantitative analysis were further corroborated and complemented by a qualitative part of the study, consisting of comparative case studies. Data were obtained through in-depth narrative interviews conducted with top management and other personnel responsible for FDI, and further complemented with relevant publications and firm financial statements, if required. Data analysis used the MaxQDA software for variable coding within the obtained interview transcripts or notes.

The findings of the study suggest that intangible assets are a relevant variable in the internationalisation of Polish MNEs, contrary to a frequent claim on MNEs from emerging markets. Meanwhile, the still limited scope of international operations and concentration on proximate markets indicate that Polish firms are still “infant MNEs.” Moreover, while most Polish firms expand gradually, by preceding equity entry modes with exports to target markets, numerous firms also internationalise by leapfrogging the export stage. The study also devotes attention to the performance outcomes of foreign affiliates, as well as their contribution to the entire firm's performance. Concerning the direct effect of host-country variables on FDI performance, economic outcomes of foreign affiliates are the highest in geographically and culturally closest markets of the EU-13. FDI experience has a beneficial effect on FDI contribution to MNE performance, although this effect is contingent on the dominant FDI motive. For market-seeking FDI, it seems that FDI experience enables learning effects in terms of increasing market-related outcomes. Conversely, for efficiency-seeking FDI the influence on the parent decreases with a higher scope and duration of international operations, since the marginal efficiency effect in larger MNE networks appears to be smaller.

As regards the effect of MNE size on performance contribution of FDI for the entire firm is concerned, an increasing size of the multinational firms turns out to strengthen the positive effects of undertaking FDI on different dimensions of MNE performance. However, from a certain threshold of firm size, as the scale of international business operations rises, the costs of managing MNE complexity increase. Moreover, the nature of operations and the underlying business model constitute an important variable which affects the extent to which firms are able to leverage foreign expansion, for affiliates with a broader scope of value-adding activities turn out to be the most strongly contributing to MNE performance.

The logic of the book's reasoning is synthetically illustrated in Figure 1.



**Figure 1.** Conceptual approach of the volume

Source: own work.

#### 1.4. Book structure

After the short introductory chapter, whose aim is to justify the adopted scope of research and present the key objectives of the present study, the second chapter is of theoretical character and briefly discusses the most widespread microeconomic theories explaining FDI, as well as chosen models of firm internationalisation, which are directly related to FDI, its motives and forms. Distinction is made between dynamic models, rooted predominantly in management-related concepts, and static concepts embedded in economic sciences. By delivering a review of existing theoretical concepts, the chapter devises a conceptual foundation for subsequent chapters devoted to performance, as it provides an array of antecedents of FDI motives and performance.

In the third, also conceptual chapter, MNE strategies are discussed, including various FDI modes. Subsequently, the chapter clarifies notions related to firm competitiveness and discusses them in the specific context of MNEs. This conceptual summary is worthwhile undertaking, given the vast heterogeneity of both conceptualisation and operationalisation of performance among different sub-disciplines of economics and management, but also even within the same sub-disciplines.

The fourth chapter adds to the findings of Chapters 2 and 3 by discussing the peculiar character of internationalisation of firms from emerging markets, with a particular focus on statistical data and studies devoted to Polish firms. The main objective thereof is to include the specificity of Polish firms' internationalisation behaviour in the present empirical study. The findings concerning the Polish context are also synthetically compared and contrasted with broader literature on other CEE firms, as well as other emerging markets. Secondary data on Polish outward investment is then followed by a detailed discussion of the results of the author's own empirical study using quantitative and qualitative methods. Before the findings are presented, details on data collection and the research sample are presented. Last but not least, the fifth chapter discusses the empirical findings with emphasis on the implications for international business theory, business practice and economic policy.