

**HOW CONTEXT MATTERS:  
NON-MARKET ADVANTAGES OF DEVELOPING-COUNTRY MULTINATIONAL  
COMPANIES \***

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**HOW CONTEXT MATTERS:  
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We analyze the non-market advantages of developing-country multinational companies (DMNCs) over those of advanced-economy multinational companies (AMNCs) when both operate in the same host country. We build on the resource-based theory and the concept of distance between countries to argue that dimensions of a country's environment can be classified into three types, with differing implications for the advantage of DMNCs in comparison to AMNCs. First, for dimensions of the environment on which countries cannot be ranked in terms of development, a comparison between DMNCs and AMNCs cannot be established; MNCs from more distant home countries have a disadvantage compared to MNCs from less distant countries. Second, for dimensions of the environment on which countries can be ranked in terms of development and that provide external resources that support the firm's operations, DMNCs tend to enjoy an advantage over AMNCs. Third, for dimensions of the environment on which countries can be ranked in terms of development and that force the firm to improve competitiveness, DMNCs face a disadvantage against AMNCs.

Keywords: developing country multinational companies, advanced economy multinational companies, distance, competitive advantage, resource-based theory

As developing-country multinational companies (DMNCs) increasingly expand abroad, they provide new competition to advanced-economy multinational companies (AMNCs); however, the manner in which they do this needs to be studied further. Most of the literature on DMNCs has focused on their market-based advantages, i.e., advantages based on resources developed to compete against other firms in the industry, such as simple technologies (e.g., Lall, 1983; Wells, 1983) or nimbleness and flexibility (e.g. Bonaglia, Goldstein and Mathews, 2008; Mathews, 2006).

In contrast, this paper focuses on the non-market advantages of these firms; that is, advantages based on resources developed by the firm to operate in its home country environment. Whereas both DMNCs and AMNCs can develop similar market-based advantages, the same cannot be said of their non-market advantages because these are rooted in the home country environment, and the home countries of DMNCs and AMNCs differ markedly. For example, DMNCs develop non-market resources to manage under poorly developed institutions in their home countries, which gives them an advantage over AMNCs in other countries with poorly developed institutions (e.g., Cuervo-Cazurra, 2006; Cuervo-Cazurra and Genc, 2008; del Sol and Kogan, 2007; Khanna and Palepu, 2006).

We provide additional depth to this idea by building on the resource-based theory (RBT) and the concept of distance between countries (Johanson and Vahlne, 1977) to argue that dimensions of country environment can be classified into three types, with differing implications for the non-market advantages of DMNCs in relation to AMNCs when both compete in the same host country. First, for dimensions of the environment on which countries cannot be ranked in terms of development, a comparison between DMNCs and AMNCs cannot be established. One can only say that MNCs from more distant home countries have a disadvantage against MNCs from less distant countries. Second, for dimensions of the environment on which countries can be ranked in terms of development and that provide external resources that support the firm's operations, DMNCs tend to enjoy an advantage over AMNCs. Third, for dimensions of the environment on which countries can be ranked in terms of development and that force the firm to improve competitiveness, DMNCs face a disadvantage against AMNCs.

These arguments make three contributions to the literature. First, they contribute to the RBT by explaining non-market resources and the advantage they provide in detail, thus refining the institution-based view of strategy (Meyer et al, 2009; Peng, Wang and Jiang, 2008). Second, they refine previous studies of distance between countries by proposing that distances may result in advantages as well as disadvantages for the firm abroad, depending on the direction of movement. Previous literature has assumed that distance has a negative impact on the operations of the MNC abroad and that the direction of movement does not matter (Ghemawat, 2001; Johanson and Vahlne, 1977). Third, they contribute to the growing literature on DMNCs (see the articles in the special issues edited by Auklak, 2007, and Luo and Tung, 2007, and in the books edited by Sauvant, 2008, and Ramamurti and Singh, 2009). The arguments explain how DMNCs can enjoy non-market advantages or suffer non-market disadvantages in comparison to AMNCs. This extends previous studies that have only discussed some of the non-market advantages of DMNCs (Cuervo-Cazurra and Genc, 2008; Khanna and Palepu, 2006).

## **THEORETICAL BASIS**

We build on the resource-based theory (RBT) because it provides the basis for understanding non-market resources. In the RBT, a firm is a bundle of heterogeneous resources that are used to create products or services that satisfy the needs of customers (Penrose, 1959). In

this study, resources include a firm's assets, capabilities, competencies and knowledge. One can classify a firm's resources into two types (Baron, 1995; Penrose, 1959): market resources and non-market resources. First, market resources are those resources that the firm develops and utilizes to compete against other firms in the industry, such as efficient production plants, brand names or product innovations. The RBT literature in strategic management has mostly focused on such resources (e.g., Peteraf, 1993). Similarly, many asset-based ownership advantages discussed in the international business literature refer to market resources (Dunning, 1977; Rugman and Verbeke, 1992). In our view, DMNCs and AMNCs can both develop similar market resources that give them an advantage in their home country and induce them to expand abroad (Hymer, 1976). Second, non-market resources are those resources that the firm develops and uses to interact and operate with its environment, such as knowledge of the local language and customs or understanding of laws and regulations. Despite the relatively little attention they receive in the strategic management literature, non-market resources can provide firms with an advantage at home, such as when they benefit from political connections (Baron, 1995; Ghemawat and Khanna, 1998), and abroad, such as when their knowledge of difficult institutions enables them to better operate in countries with poor institutions (Cuervo-Cazurra, 2006; Cuervo-Cazurra and Genc, 2008). Thus, non-market resources are related to foreign institutional knowledge (Eriksson et al., 1997) or ownership-specific institutional advantages (Dunning and Lundan, 2008).

We also build on the concept of psychic distance between the home and host countries (Johanson and Vahlne, 1977) because it provides the basis for understanding the value of non-market resources abroad. Psychic distance is the sum of factors preventing the flow of information from and to the market, such as differences in language, education, business practices, culture and industrial development (Johanson and Vahlne, 1977: 24). It has a negative impact on the foreign expansion of the firm (Eriksson et al., 1997; Ghemawat, 2001) because as the firm expands into countries that are more distant from its home country, it can use fewer of the resources developed at home. Past studies of distances are built on two assumptions. First, distance between home and host country always results in a disadvantage to the firm. Second, distance is directionless, that is, going from Country A to Country B is as challenging as going in the other direction.

Extending these two theoretical bases and challenging the assumptions, we classify dimensions of the environment into three types depending on how they impact the development of non-market resources at home and the value of such resources abroad. This classification details how non-market resources can lead to an advantage or disadvantage abroad, and demonstrates how distance can result in advantages as well as disadvantages for the firm, depending on the direction of movement. The three dimensions of the environment we propose are the following. First, some dimensions of the environment are unrelated to a country's level of development. Even if one can measure the dimension and assign numbers to countries, higher numbers do not imply that the country is better. In these dimensions, moving to a more distant country creates a greater disadvantage, regardless of the direction of movement. This is the traditional conceptualization of distance in the literature. Second, some dimensions of the environment on which countries can be ranked by development provide external resources which support the operations of the firm. In these dimensions, countries can be ranked in terms of development depending on the quality and quantity of resources they provide. Moving to a more developed host country levels the playing field because all firms benefit from the externally-provided resources, while moving to a less developed host country creates disadvantages because

supportive resources are absent from the environment. Third, other dimensions of the environment on which countries can be ranked by development induce the firm to improve the competitiveness of its non-market resources to be able to operate in a highly demanding environment. Hence, moving to a more developed country results in a disadvantage because the firm would not have developed such resources at home, while moving to a less developed country generates an advantage because the firm is used to operating in a more demanding environment.

Before we discuss these ideas in more detail and apply them to the analysis of the advantages of DMNCs over AMNCs, we establish the following boundary conditions. First, we only consider market-seeking foreign expansion. We do not discuss resource- or asset-seeking FDI. Second, we analyze the advantages and disadvantages of firms from different home countries operating in the same host country. We do not compare foreign firms to domestic ones. Third, we compare foreign firms at the beginning of their operations in the country. We do not study how foreign firms overcome disadvantages and build advantages abroad over time. Finally, we focus on the heterogeneity of firms from different countries that arise due to differences in their home country environment. We do not discuss heterogeneity of firms that arises from differences in firm-specific resources, including resources that enable the firm to operate in multiple countries (Henisz, 2003). Finally, we study firm-specific advantages and disadvantages developed by a firm. We do not discuss country-specific advantages that support a firm's advantage abroad (e.g. Rugman and Verbeke, 1992).

### **NON-MARKET ADVANTAGES OF DMNCs**

We now discuss these three types of dimensions of the environment and how differences between countries on each one result in an advantage or disadvantage for DMNCs in relation to AMNCs when both operate in the same host country.

#### **Dimensions That Cannot Be Ranked in Terms of Development**

For some dimensions of the environment, countries cannot be ranked in terms of development. In these dimensions, the firm develops non-market resources to operate under the prevailing conditions at home. When the firm expands abroad, these resources lose value because the conditions of the foreign market are different from those at home, creating a disadvantage for the firm in relation to its home operation. This is the traditional argument of psychic distance studies (Johanson and Vahlne, 1977).

There are many dimensions of the environment on which countries cannot be ranked by development, even though they can be measured with indicators that take higher or lower values. Cultural attitudes are an example. A country cannot be considered to have a more developed culture because it scores higher values on cultural attitudes. Geographic location is another dimension on which countries cannot be ranked in terms of development. Geography creates disadvantage by creating transportation and communication costs. Certain social dimensions such as religion and ethnic composition also fall into this category. The firm faces disadvantages whenever it moves into a country that is different from its home country, due to the firm's lack of understanding of local norms. Some political dimensions, such as colonial ties between countries or membership in a political association, do not allow countries to be ranked as more or less developed as well. A firm that moves to a country that does not have a tie to its home country would be deprived of a potentially preferential relationship and thus face a disadvantage. Finally, the legal family of the host country, i.e. whether the laws are based on the English, French,

Scandinavian, German or Islamic tradition, cannot be ranked in terms of development; they are just different traditions.

Figure 1 illustrates three possible cases of firms from different home countries competing in the same host country. In the first (1a) and second (1b) cases, firms from different home countries enter a country that has a higher (1a) or lower (1b) value in that dimension than both home countries. Both firms face a disadvantage compared to their home operations, but the firm from the more distant home country faces a larger disadvantage. As a result, the firm coming from the less distant country has an advantage over the firm coming from the more distant country. In the third situation (1c), one firm comes from a country that has higher values in the dimension than the host country, while the other comes from a country that has lower values than the host country. Both companies face an equal disadvantage in relation to their home operation, because the direction of movement is not relevant and they are equidistant from the host country. Therefore, neither firm has an advantage over the other.

\*\*\* Insert Figure 1 here \*\*\*

For these dimensions, one cannot analyze the advantage of DMNCs over AMNCs because such a dichotomy becomes meaningless. The only characteristic that matters is the absolute distance between the home and host countries. Therefore, we propose that:

*Proposition 1a: For dimensions of the environment that cannot be ranked in terms of development, an MNC that comes from a country more distant to the host country will face a greater disadvantage than another MNC from a less distant country. Therefore, the latter has an advantage over the former. A comparison between DMNCs and AMNCS cannot be established.*

A special case of this type of dimension emerges when dimensions are categorical variables. Here, the notion of relative distance breaks down, and one can only assess whether home and host country are in the same category or not. For example, a host country either has a free trade agreement or a common border with an MNC's home country, or it does not. In such cases, the predictions change slightly because the disadvantages cannot be compared: a firm coming from a particular home country either faces a disadvantage or not. Thus, we propose that:

*Proposition 1b: For dimensions of the environment that cannot be ranked in terms of development and are categorical, an MNC whose home country falls in a different category than the host country will face a disadvantage compared to an MNC whose home country falls into the same category as the host country. When both MNCs come from home countries that differ from the host country, both face a disadvantage compared to their home operations, but their disadvantages cannot be compared. A comparison between DMNCs and AMNCS cannot be established.*

### **Dimensions That Can Be Ranked in Terms of Development and Support Firm Operations**

Other dimensions of the environment allow countries to be ranked in terms of development and provide external resources that support the firm's operations. In these dimensions, firms benefit from being in more developed countries because the environment provides supporting resources and the firm does not have to invest in developing them. These resources are external to the firm; as a result, it cannot transfer them abroad. Therefore, when the environment abroad does not provide such supporting resources, the firm has to incur the expenses of developing them (Fisman and Khanna, 2004).

Several institutional, social and physical infrastructure dimensions of the environment fall into this category. First, institutional dimensions such as the quality of public goods, property rights, quality of the judicial system, rule of law and control of corruption all support the operations of the firm by facilitating its contracting and economic exchanges (Djankov et al.,

2002). Second, the quality of a country's human capital in the form of a well-educated and skilled workforce supports the operations of the firm. Third, the quality of physical infrastructure supports firm operations in the country because the firm relies on it to receive and send information and physical goods (Porter, 1990).

Figure 2 illustrates three alternative cases of firms from different home countries competing in the same host country. In the first case (2a), the firms enter a country which is more developed than both home countries in the dimension in question, and both benefit equally from operating there because they do not have to invest in developing supporting resources. In contrast, in the second case (2b), the firms enter a host country which is less developed than both home countries in that dimension, and both face a disadvantage in comparison to their home operations because they lack supporting resources. However, the firm from the more developed country faces a larger disadvantage than the other firm because it needs to invest more in developing these resources; the firm from the less developed country already has some expertise in developing them. In the third situation (2c), one firm comes from a country that is more developed than the host country and the other from a country that is less developed than the host country. The firm from the less developed country enjoys an advantage in comparison to its home operation because it can now rely on the environment for supporting resources that it previously had to develop itself, while the firm from the more developed country suffers a disadvantage in comparison to its home operation because it now has to develop resources that it used to obtain from the environment at home. Thus, in both (2b) and (2c), the firm coming from the less developed country has an advantage over the other firm.

\*\*\* Insert Figure 2 here \*\*\*

In these dimensions one can compare DMNCs and AMNCs as long as the ranking of countries as more or less developed is based on the specific dimension being analyzed. Thus, the DMNC is the firm from the country that is less developed in that dimension while the AMNC is the company from the country that is more developed. In these dimensions, DMNCs tend to have an advantage over AMNCs because they can better cope with a low level of development. Whereas in situation 2a both the DMNC and the AMNC have similar advantages, in situations 2b and 2c the DMNC either suffers a smaller disadvantage than the AMNC, or enjoys an advantage while the AMNC suffers a disadvantage. Therefore, we propose that:

*Proposition 2a: For dimensions of the environment that can be ranked in terms of development and support the operations of the firm, a DMNC and an AMNC will not have an advantage over one another when both home countries are less developed than the host country in which the firms compete.*

*Proposition 2b: For dimensions of the environment that can be ranked in terms of development and support the operations of the firm, a DMNC will have an advantage compared to an AMNC when both home countries are more developed than the host country in which the firms compete.*

*Proposition 2c: For dimensions of the environment that can be ranked in terms of development and support the operations of the firm, a DMNC will have an advantage compared to AMNC when the host country in which firms compete is more developed than the home country of the DMNC but less developed than the home country of the AMNC.*

### **Dimensions That Can Be Ranked in Terms of Development and Induce Competitiveness Upgrades**

Some dimensions of the environment on which countries can be ranked by level of development induce a firm to upgrade its competitiveness. In such cases, the firm has to

continuously upgrade its non-market resources in order to operate in the home country. When the firm expands into a less developed country, it faces a less demanding environment where its superior resources give it an advantage, whereas when it expands into a more developed country it faces a disadvantage because it is unaccustomed to dealing with such demands.

Some economic and political dimensions of the environment fall into this category. First, wealthy consumers tend to be more demanding in terms of the environmental and social issues involved in the making of products they purchase (e.g. child labor, animal testing, fair trade) than consumers in developing markets. Second, advanced capital markets are more stringent in their evaluation of the quality of information provided and the quality of corporate governance in the firm. Third, a complex political system with extensive political rights and civil liberties puts more pressure on the firm to be more sophisticated in how it satisfies multiple vocal stakeholders with competing demands (e.g. political parties, NGOs, activists, press). This explains why AMNCs tend to be better in their environmental, labor, and social relations and how AMNCs can successfully operate in authoritarian states where there are fewer stakeholders to satisfy (Bellak, 2004).

Figure 3 illustrates three alternative situations where firms from different home countries compete in the same host country. In the first situation (3a), both firms come from countries that are less developed than the host country and both suffer from a disadvantage compared to their home operations, but the firm coming from the less developed country suffers from a larger disadvantage because it is less used to dealing with a demanding country environment than the other firm. In the second situation (3b), both firms come from countries that are more developed than the host country and both are better off than at home, but the company that comes from the most developed country has an advantage over the other because it has developed the most sophisticated non-market resources. Finally, in the third case (3c), one firm comes from a more developed country and the other from a less developed country than the host country. Here, the firm coming from the less developed country suffers from a large disadvantage against the firm coming from the more developed country; while the former is not used to the higher demands of the host country, the latter has developed more sophisticated resources and faces a less demanding environment.

\*\*\* Insert Figure 3 here \*\*\*

We can compare DMNCs and AMNCs in these dimensions as long as the classification of developing vs. developed is based on the dimension in question. Once again, the DMNC is the firm from the less developed country and the AMNC is the firm from the more developed country in that dimension. Unlike the previous case however, DMNCs tend to be at a disadvantage against AMNCs. In situation 3a, both firms face a disadvantage compared to their home operations, but the DMNC faces a larger disadvantage than the AMNC. In situation 3b, both firms have an advantage compared to their home operations, but the DMNC has a smaller advantage than the AMNC. In situation 3c, the DMNC suffers a disadvantage while the AMNC enjoys an advantage compared to their home operations. Therefore, we propose that:

*Proposition 3: For dimensions of the environment that can be ranked in terms of development and induce competitiveness upgrades, a DMNC will suffer a disadvantage compared to an AMNC when both compete in the same host country.*

## CONCLUSIONS

In this paper we analyzed the non-market advantages of DMNCs in relation to AMNCs. Recent studies have argued that DMNCs enjoy certain non-market advantages, such as

knowledge of how to operate in countries with underdeveloped institutions (e.g., Cuervo-Cazurra and Genc, 2008). We provided depth to these ideas by relaxing the assumptions underlying studies of distance and arguing that dimensions of a country's environment can be classified into three types depending on whether they can be ranked by level of development or not, and whether they support operations or induce competitiveness improvements. This classification results in specific predictions regarding the relative advantages and disadvantages of MNCs from different home countries competing in the same host country. It also shows that classification of firms as DMNC vs. AMNC should be based on the dimension of the environment in question, and that for many dimensions such a distinction cannot be established.

These arguments make three contributions. First, we extend the RBT to explain how resources that a firm develops to manage in its home country environment can provide the firm with a non-market advantage abroad, providing depth to the institution-based view of the firm (Peng, Wang and Yiang, 2008; Meyer et al., 2009). Different from most studies of international business that focus on studying how conditions in the *host* country affect the behavior and performance of foreign firms (e.g., Henisz, 2000; Meyer, 2004), we highlight how conditions in the *home* country affect a firm's advantage abroad (e.g., Cuervo-Cazurra, 2007, 2008; Cuervo-Cazurra and Genc, 2008).

Second, we refine the concept of psychic distance and challenge the assumptions that distance has a negative impact on a firm's internationalization and that the direction of movement does not matter (Johanson and Vahlne, 1977; Ghemawat, 2001) by proposing that different types of distance and the direction of movement have different impacts on the firm's advantage abroad. The proposed framework is flexible and can easily accommodate specific dimensions of the environment the researcher wants to study because we present the conditions for classifying any given dimension. Once a dimension is classified into one of the three types discussed, the implications for the firm's advantage or disadvantage in a host country can be easily derived.

Third, we contribute to the literature on competition between DMNCs and AMNCs by providing a theoretical framework to evaluate their non-market advantages. This competition has intensified as DMNCs develop new strategies to expand abroad and face AMNCs (Bartlett and Ghoshal, 2000; Cuervo-Cazurra and Genc, 2008; Ghemawat and Hout, 2008; Guillen and Garcia-Canal, 2008; Luo and Tung, 2007; Ramamurti and Singh, 2009). We differ from previous studies that have classified countries into two groups based on their income per capita and instead propose that the classification of home countries should be dimension-specific. Such classification not only allows for more refined predictions regarding the advantage of DMNCs in relation to AMNCs, but also questions such a dichotomy for many dimensions of the environment. Moreover, the proposed framework provides a more refined understanding of how DMNCs enjoy non-market advantages in comparison to AMNCs or suffer non-market disadvantages when both operate in the same host country.

The framework presented here is also useful for managers. As DMNCs expand globally, competition between them and AMNCs will intensify. Before making any entry decisions, managers of DMNCs should think about the implications of relative distance they face in each dimension of the environment compared to rivals coming from other home countries.

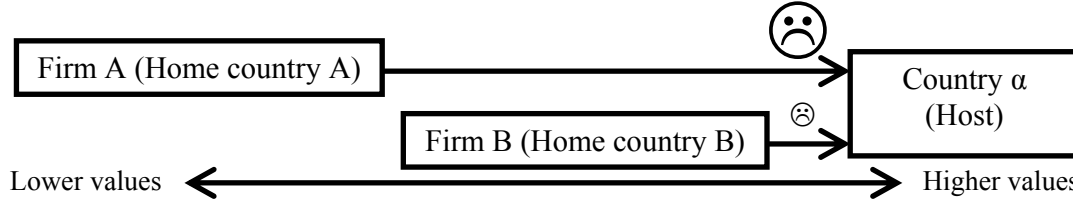
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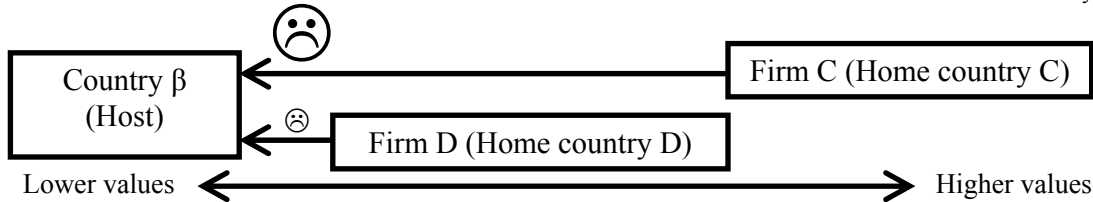
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Figure 1. Dimensions of the environment that cannot be ranked in terms of development

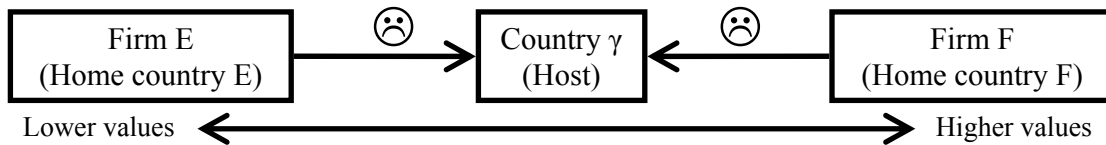
Situation 1a. Firms from different home countries (A, B) enter the same host country  $\alpha$ , which has higher values in the dimension of the environment than both home countries and is at a different distance from each home country



Situation 1b. Firms from different home countries (C, D) enter the same host country  $\beta$ , which has lower values in the dimension of the environment than both home countries and is at a different distance from each home country



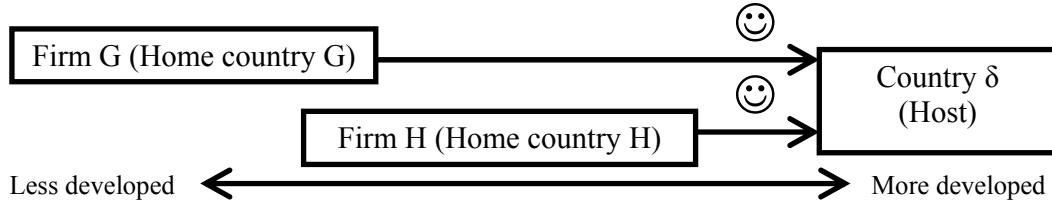
Situation 1c. Firms from different home countries (E, F) enter the same host country  $\gamma$ , which has higher values than Country E but lower values than Country F in the dimension of the environment, and is at an equal distance from both countries



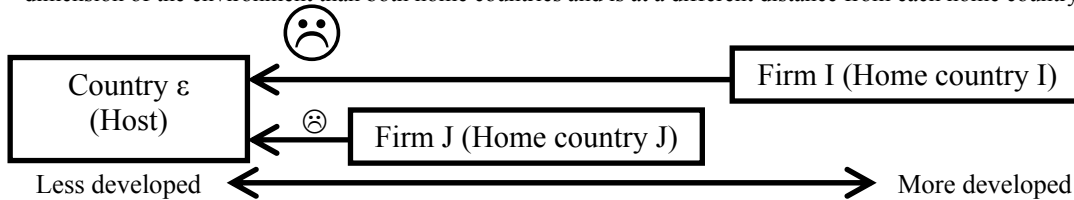
Note: The length of the arrow linking home and host country represents the difference or distance between home and host in that dimension. The smile face represents advantage and the frown face represents disadvantage. The size of the face indicates the relative size of such advantage or disadvantage.

Figure 2. Dimensions of the environment that can be ranked in terms of development and support the operations of the firm

Situation 1a. Firms from different home countries (G, H) enter the same host country  $\delta$ , which has higher values in the dimension of the environment than both home countries and is at a different distance from each home country



Situation 1b. Firms from different home countries (I, J) enter the same host country  $\epsilon$ , which has lower values in the dimension of the environment than both home countries and is at a different distance from each home country



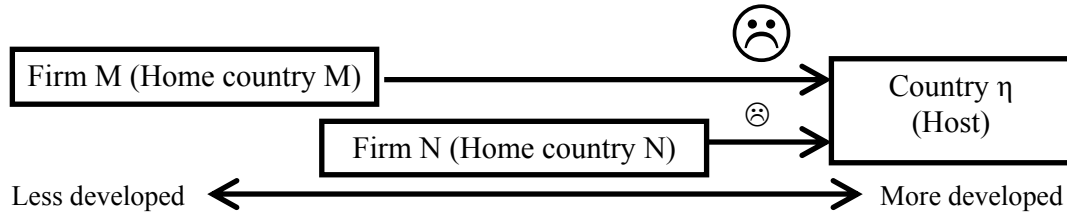
Situation 1c. Firms from different home countries (K, L) enter the same host country  $\zeta$ , which has higher values than Country K but lower values than Country L in the dimension of the environment, and is at an equal distance from both countries



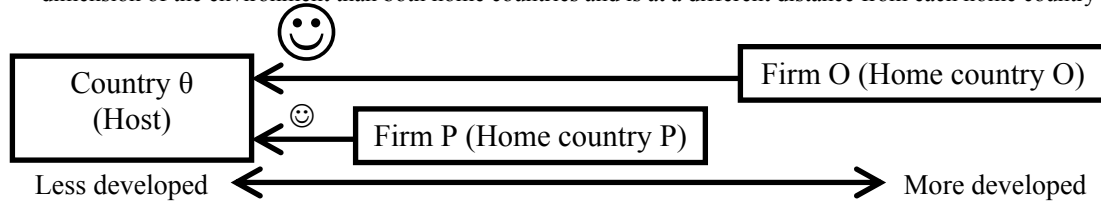
Note: The length of the arrow linking home and host country represents the difference or distance between home and host in that dimension. The smile face represents advantage and the frown face represents disadvantage. The size of the faces indicates the relative size of such advantage or disadvantage.

Figure 3. Dimensions of the environment that can be ranked in terms of development and induce firms to upgrade resources

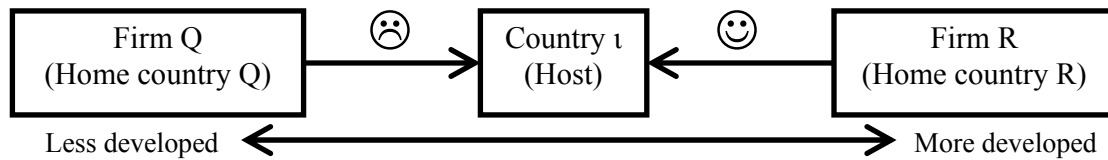
Situation 1a. Firms from different home countries (M, N) enter the same host country  $\eta$ , which has higher values in the dimension of the environment than both home countries and is at a different distance from each home country



Situation 1b. Firms from different home countries (O, P) enter the same host country  $\theta$ , which has lower values in the dimension of the environment than both home countries and is at a different distance from each home country



Situation 1c. Firms from different home countries (Q,R) enter the same host country  $\iota$ , which has higher values than Country Q but lower values than Country R in the dimension of the environment, and is at an equal distance from both countries



Note: The length of the arrow linking home and host country represents the difference or distance between home and host in that dimension. The smile face represents advantage and the frown face represents disadvantage. The size of the face indicates the relative size of such advantage or disadvantage.