Introduction: Translating potential into profits: foreign multinationals in emerging markets since the nineteenth century

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Published online: 27 May 2015.
Introduction: Translating potential into profits: foreign multinationals in emerging markets since the nineteenth century

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Emerging markets trigger great expectations. Many foreign multinationals are eager to exploit the entrepreneurial opportunities potentially related to less developed but fast growing markets. This is not a new phenomenon. Multinationals from more developed countries have for long searched for opportunities in less developed markets and have dealt with the related challenges. Foreign environments with different needs and capabilities, unstable institutions and policies, stark fluctuations in the macroeconomic environment and unrealistic expectations are just some of the obstacles for ‘turning potential into profits.’ The history of multinational enterprises (MNEs) knows many examples of economies with these characteristics similar to modern understandings of ‘emerging markets.’ This special issue analyzes foreign multinationals in emerging markets from a historical perspective. It seeks to understand changes and continuities in the opportunities and challenges less developed markets presented for MNEs, and in the various ways in which their managers responded to these. Rather than relying on the ‘emerging market’ label, we ask (1) why managers perceived certain markets as ‘emerging’ and which expectations they had when investing in these markets, (2) which challenges they faced there, and (3) how they subsequently addressed them. By tracing and comparing these investments and their consequences over time (and space), we hope to shed more light on managerial decisions and understand to what extent they were shaped by the specific context or, possibly, had more of a timeless nature – with the findings ultimately intended to help inform contemporary decision-making. This introduction to the special issue describes the framework for the following six papers on foreign multinationals in emerging markets since the nineteenth century.

Keywords: international business; emerging markets; business history; multinationals; organizational history

‘Emerging markets: Lands of eternal promise,’ titled The Economist in a May 2013 special issue, describing companies from the Western world ‘descending on developing economies . . . with great fanfare.’ Growth rates and development prognoses seemed to suggest highly lucrative returns. ‘Champagne flowed as the chief executives from head office snipped ribbons to open the glitzy new outposts’ (2013, 16). However, most of these great expectations were never met and according to the journalists many multinational corporations were forced to learn expensive lessons. Foreign environments with different needs and capabilities, unstable institutions and policies, stark fluctuations in the macroeconomic environment, and unrealistic expectations are just some of the obstacles for ‘turning potential into profits.’

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The basic premise of this special issue is that both these expectations and the associated challenges are not new, but were faced by multinational enterprises (MNEs) for as long as foreign investments were made (Jones 2013, 13–56; Jones 2010). The history of MNEs knows many examples of economies with characteristics similar to modern understandings of ‘emerging markets.’ Suffice to point to the case of Singer, which created and dominated the market for sewing machines in pre-revolutionary Russia, or Unilever, which generated substantial profits from markets like Brazil, India, and South Africa during the 1960s and 1970s – a period marked in all these countries by nationalistic government policies, including import substitution and ownership restrictions (Arnold 2013; Godley 2006; Jones 2005a, 2005b).

It is for that reason that this special issue analyzes foreign multinationals in emerging markets from a historical perspective. It seeks to understand changes and continuities in the opportunities and challenges less developed markets presented for MNEs, and in the various ways in which their managers responded to these. Rather than relying on the ‘emerging market’ label – apparently first coined in 1981 by then World Bank economist Antoine van Agtmael (see van Agtmael 2007, 1–6; also Khanna, Palepu, and Bullock 2010, 3), we focus more broadly on the investments made by MNEs in less developed countries that were expected to grow rapidly and examine these investments over time and across different national, regional, and industry contexts. We ask (1) what expectations MNEs and their managers had when investing in these markets, (2) which challenges they faced there, and (3) how they subsequently addressed them. By tracing and comparing these investments and their consequences over time (and space), we hope to shed more light on managerial decisions and understand to what extent they were shaped by the specific context or, possibly, had more of a timeless nature – with the findings ultimately intended to help inform contemporary decision-making.

The contributions in this special issue move beyond the current context – often wrongly presented as unique and unprecedented – and examine the motivations for foreign firms to invest in these less developed but high potential markets at different points in time, the strategy mix they employed and the variety of ways in which they overcame the associated challenges, as well as the (positive or negative) consequences of their investments for themselves and the host economy. In what follows, we first relate our approach to the extant literature on the ‘emerging economies’ and show how we build on this literature but also extend it by taking into account the historical dimension, i.e., continuities and changes over the long run. Then, to situate the different articles in these broader developments, we provide a brief overview over the history of the global economy. Finally, we highlight and discuss a number of recurring themes across all articles and how they might contribute to current debates, viz. the dealings of MNEs with host country governments, the crucial role of business networks, increasing challenges by local competitors, and the difficult trade-offs between global integration and local responsiveness.

Understanding emerging economies: the contributions of an historical approach

While references to emerging markets have become ubiquitous, the concept tends to be only loosely defined. Much public and scholarly attention has recently been paid to what Goldman Sachs analyst Jim O’Neill in a 2001 paper referred to as the BRICs – Brazil, Russia, India, and China – and more generally to a number of economies rapidly moving from a less to more developed state, which are now also seen to include South Korea and South Africa or even Africa as a whole (O’Neill 2011, 2001). Classifications by the United
Nations, the World Bank, or the International Monetary Fund (IMF) differ depending on the operational needs of each of those institutions, but do offer some measurable criteria, such as gross national income per capita (World Bank) or composition of export earnings (IMF), among other criteria (IMF 2013; Nielsen 2011). Despite their heterogeneity and the fact that emerging markets do not share a common agenda or have a joint political voice, many experts believe that their economic and political influence in the world economy is increasing and that a transformative, tectonic shift in the distribution of political power is upon us. With this come more metaphorical descriptors, such as the ‘rise of the rest’ (Zakaria 2009; see also Amsden 2001).

Research on emerging markets is being conducted within management and political sciences, and several definitions exist side by side. American management scholars Haley and Haley (2006), for instance, define emerging markets as those in low and middle-income countries. Montiel (2011) uses the term to denote a subgroup of developing economies that have become closely linked with international capital markets. Russian manager and economist Vladimir Kvint (2009) examines the political context, arguing that an emerging market country is a society transitioning from an autocratic regime to a free-market-oriented economy, with increasing economic freedom and continuing participation in the world economy.

Several authors look at institutions, or the lack thereof. Peruvian economist de Soto (2010) argues that stable property rights and easy access to the legal system open the way to development for emerging markets. Focusing on the flipside, Khanna, Palepu, and Bullock (2010) characterize different emerging markets by their lack of institutional infrastructure, which they see as an obstacle to expanding business operations, because many of the specialized intermediaries in capital, product, and labor markets that are available in developed countries are absent or inefficient – making it difficult, if not impossible for buyers and sellers to come together. At the same time, they also highlight the opportunities arising from the absence of intermediaries and develop a framework for capitalizing from the lack of institutional infrastructures, e.g., by offering services that explicitly address such institutional voids. As an example they point to General Motors’ business in China, where an underdeveloped credit system prompted the company to establish China’s first automotive finance provider (Khanna, Palepu, and Bullock 2010, 92–97).

Given the widespread notion that emerging markets are a recent phenomenon, few authors have addressed the historical dimension of the concept. We believe that exploring this dimension can be helpful for three main reasons. First of all, the idea of emerging markets is based on expected future developments and the impending prospects of markets. Put differently, the emerging market terminology is based on the potential of high reward under conditions of uncertainty, without any guarantee that the prediction will eventually come true. As The Economist pointed out in 2013 (see above), in many cases growth expectations are nothing but wishful thinking. Only a handful of countries have actually grown at a consistently higher rate than advanced economies, according to the World Bank’s development indicators (World Bank 2002), and a 2014 forecast by the IMF, which predicts a general slowdown and sees emerging markets adjusting to slower growth (IMF 2014).

Moreover, given the centrality of expectations, economic as well as political, to the concept, it is worth pointing out the subjective quality of this factor. How individuals perceive the development prospects of different world regions may depend on a number of variables beyond purely economic indicators and is subject to change. Hence, even market assessment, reflected in stock prices for instance, is never entirely objective but based on
individual and collective experiences (e.g., Callon and Muniesa 2005; Callon 1998), which may lead to very different outcomes at different points in time. This makes taking a long-term, historical perspective essential. By looking at similar situations in the past, one can identify (1) the power of expectations, i.e., how and why actors considered certain less developed markets to have such a high potential, (2) the realism of these expectations, i.e., whether or not, and why, these expectations were actually met, and (3) the consequent reaction by these actors, i.e., the decisions they took to close any gap between their expectations and the realities of the investment in these markets.

Second, emerging markets are incessantly evolving. They move in and out of definitional categories, going from less developed to more developed status, or – less often talked about – vice versa. Some scholars even argue that market fluctuations and volatile business cycles, such as sharp falls in capital inflows and contractions in the country’s gross domestic product (‘sudden stop’) or subsequent quick recoveries (‘Phoenix miracle’), are a long-standing characteristic of emerging markets (Calvo, Izquierdo, and Talvi 2006). Some of those fluctuations are related to political changes in the high-risk environments of emerging markets (Casson and Lopes 2013). Whatever the trigger, there is no guarantee for economic growth and no one-way track to development. Those like Khanna, Palepu, and Bullock (2010), who argue that emerging economies are those with major institutional voids, array these markets along a continuum, ‘from entirely dysfunctional – with a plethora of institutional voids – to highly developed’ (Khanna, Palepu, and Bullock 2010, 24). Only an historical analysis can identify continuities and changes along this array and help understand their underlying reasons. Take Argentina, admittedly an extreme case, which has been an emerging economy at least since the nineteenth century, its rise being repeatedly interrupted by currency crisis, debt defaults, and political upheaval – all apparently due to an inability to create and maintain a stable political economy (e.g., Guillén 2001); or Russia and China, which at the end of the nineteenth and beginning of the twentieth century were widely seen and treated as markets with high growth potential, before internal strife and communist regimes disrupted – temporarily as is now clear – foreign investment ( Köll 2003; Cochran 2000; Cox 2000; Godley 2006; for US investment in Russia see also Wilkins 2004, 5, 289).

Third, even if thinking about emerging markets in this dynamic fashion, the underlying idea of divergences in economic development across the world is itself the result of historical processes, often only implicitly acknowledged in definitions. Historians and economists have for long debated how the wealth differences between ‘the West’ and ‘the rest’ came about, considering that in the middle of the eighteenth century China, India, and Western Europe were at similar levels of agricultural productivity and commercial development. With the Industrial Revolution, first in Britain and then in the catch-up countries of Western Europe and the United States differences emerged, and manufacturing moved from the East to the West (see, e.g., the not uncontroversial summary treatment by Pomeranz 2000). From the late nineteenth century onward, other countries started following the path of industrialization set in the West. However, the substantial wealth gap could not be closed (Bénétrix, O’Rourke, and Williamson 2012; Acemoglu and Robinson 2012; O’Rourke and Williamson 2002). Without understanding the historical origins of these divergent development paths and their impact on MNEs (Jones 2013), it might therefore be difficult to assess whether and, most importantly, how the gaps that opened in the nineteenth century can be closed and what role multinationals might be playing in these processes, both in terms of exploiting, possibly maintaining these gaps or closing them – a role that will be discussed in the next section.
Foreign direct investment: the why, where and when

Multinationals, it is generally assumed, need a competitive advantage to compete in unfamiliar foreign environments (Hymer 1976). Local firms have superior knowledge about their home market as well as the institutional, legal, and political system it is intertwined with. Ownership advantages, defined as competitive advantages of firms seeking to engage in foreign investment, are one reason why firms initially decide to go global (Dunning and Lundan 2008; Dunning 1992). They include technological and organizational capabilities, patents and trademarks, access to resources, economies of scale and scope and entrepreneurial skills. Location advantages, i.e., the locational attractions of specific countries or regions, are another reason for firms to expand their activities beyond their home market. The opportunities available in one location in combination with the ownership advantages that companies bring encourage foreign direct investments (Dunning 1992). Yet exploiting them is costly, as the literature highlights in the concept of ‘liability of foreignness.’ Distance, information asymmetries, discrimination by governments or stakeholders, and the lack of legitimacy all contribute to the obstacles foreign firms have to overcome (Eden and Miller 2004; Zaheer 1995).

To determine the strategic decision where to invest, costs and benefits of any specific location have to be evaluated, both separately and relative to other locations. The positive expectations described in the concept of emerging markets can be understood as part of the set of location advantages. As noted, it is expectations – for growth, development, or political and economic stability – that make markets attractive to foreign investors.

However, ‘foreign’ firm may be too imprecise as a category. Not all foreign firms are treated equally in their host countries. As Charles Stevens and Oded Shenkar argue, entrepreneurs and policy makers should pay closer attention to the liabilities faced by MNEs due to their country of origin – what they call the ‘liability of home’ (Stevens and Shenkar 2012, 128). This will allow them to understand the perception of different groups of investors in one host society and between different host societies. Rather than lumping foreign firms of all origins together, these authors plea for a more detailed analysis of frictions that can occur when home and host country institutions and attitudes collide. Even if investors’ actions abroad are consistent with local laws, they can provoke a backlash in the home country when they are viewed as inconsistent with norms and values there. For this more detailed understanding of liabilities, specific to individual countries and nationalities, a historical analysis can be particularly useful, if not indispensable, to detect the possible frictions, their sources, and developments (Lubinski 2014).

Over time, the context for MNEs and their strategies changed. The history of business globalization can be roughly divided in four periods (Jones 2005a, 2005b). First, a period of proto-globalization before 1850; second, a wave of globalization from the mid-nineteenth century to World War I; third, the inter-war period, which partly slowed down globalization in the context of the Russian revolution, two world wars and their aftermaths, as well as the great depression, but also showed signs of continuity and innovation; and finally the most recent period with a gradual removal of barriers to trade and investment since the 1950s and a significant push in world-wide integration since the 1980s, including the rise of the BRICs and other emerging economies. While this temporal framework allows contextualizing business challenges and entrepreneurial strategies, it clearly mirrors a one-sided perspective on the history of globalization, focusing predominantly on MNEs from Western countries. Seen from other parts of the world and/or taking the perspective of other actors will most likely produce very different narratives (see also Motohashi 2015).
An important and long-lasting structuring element of the global economy has been imperialism/colonialism. The first colonial empires were established by the most advanced maritime powers (Portugal, Spain) in the fifteenth century and set out to explore and dominate new territories and foster trade (Ringrose 2001; Abernethy 2000). They were followed by French, English, Russian, Dutch, German, Italian, and Danish empires, some of them eroding quickly, others lasting until well into the twentieth century. Since the mid-nineteenth century, at the latest, imperial expansion in combination with the predominant free trade policy increased the intensity of international links. Much international investment and colonial expansion then was based on exporting manufactured goods from the West and exploiting natural resources in the less developed ‘periphery,’ where raw materials were sourced.

Multinationals from countries engaged in colonialism profited from home governments’ political influence and from the institutions implemented, often by force, in colonial territories. These institutions were modeled after the ones in the respective home markets and were thus both familiar and fairly reliable. Great Britain’s empire developed into the largest during the nineteenth century and British multinationals were leading the run for global markets (Cain and Hopkins 2001). However, the British Empire and colonial markets more generally remained open to firms from outside the respective empires (Lubinski 2014; Arnold 2013; Dejung 2013). As the twentieth century progressed, global business was often more intimately linked to nation states; a fact that facilitated the perseverance of empires and created obstacles for firms from outside these trading zones. Moreover, by spreading ideas and institutions around the globe, internationalization helped develop a greater sense of nationality at the center and triggered rebellions against foreign control in many countries of the periphery (Ballantyne and Burton 2012), often with negative effects on multinationals’ business (Jones 2010).

Within this context, it is certainly justified to look at different descriptions of less developed or rapidly developing markets over time and identify variances and continuities. The rhetorical differences between ‘colonial,’ ‘developing,’ and finally ‘emerging’ markets point to the question what the changing terminology means for business practices and the underlying cognitive concepts. It leads to a research agenda, which binds together more closely the history of multinationals’ expansion and the language used to describe it (Lipartito 2013). Thus, many countries at different times were considered emerging economies according to the criteria above, attracting sometimes substantial foreign direct investments. Looking at how multinationals approached emerging markets, why they considered them ‘emerging’ in a specific historical context, and which challenges and opportunities they responded to is important for understanding the concept of less developed but fast growing markets and the entrepreneurial strategies in approaching them, which is what the contributions in this volume do – leading to a number of more general insights briefly summarized in the next section.

**Recurrent themes of the contributions**

The contributions to this special issue cover a wide range of temporal and spatial contexts. They focus on different countries, regions, and industries; and they deal with a variety of challenges faced by multinationals in colonial, developing, and emerging markets. Despite their heterogeneity all papers deal to varying degrees with the issues of expectations under uncertainty; evolving economic, political, and institutional contexts in these markets; and the historical context of uneven distribution of wealth. They come together in four larger themes: (1) multinationals’ dealings with governments, (2) the creation and utilization of
business networks, (3) the ambiguous relationship with local competitors, and (4) the trade-off between global integration and local responsiveness. Let us address each of them in turn.

The power of governments as a recurring theme concerns in particular, but not only the period after World War I. The papers show that the institutional rules of the game, including policy measures and tariffs, had a significant impact on foreign multinationals’ activities in different host countries (Lanciotti and Lluch; Johanson and Kao; Taylor, in this volume). Colonialism appears as a significant factor for foreign investment in many less developed countries, albeit with varying results (Sluyterman and Bowens; Lubinski; Taylor, in this volume). The success of MNEs depended to a large degree on institutional stability, the protection of property rights, and a functioning legal system. Several authors also highlight the considerable fluctuations over time in the effectiveness of governments and in their relationship to market actors (Johanson and Kao; Lanciotti and Lluch; Taylor, in this volume). Over the course of the twentieth century many national governments implemented rules and regulations to protect local business endeavors (see also below), limit foreign direct investments or force multinationals to hire locals rather than foreigners. In this respect, the historical approach in the various contributions brings to the fore how multinationals over time developed skills and strategies in dealing and negotiating with governments.

Business networks are shown to be of crucial importance in promoting foreign investments in all of the cases examined in this special issue. These networks, based on ethnicity, religion, family ties, or friendship, helped deal with challenges of international business activities, such as low trust levels, inadequate information flows, weak institutions, and scarce resources. In such situations, small groups with shared values held major advantages as entrepreneurs and the active creation of networks is shown to have important pay-offs in several of the contributions (Lavista; Lanciotti and Lluch; Taylor, in this volume). While networks mostly were an alternative to internalizing certain functions, some multinationals created a global network of more or less independent affiliates under the umbrella of one firm (Sluyterman and Bowens; Taylor, in this volume). Both strategies showed advantages for knowledge transfers and raising capital in specific historic contexts. Today’s highly diversified business groups, a lasting feature of many less developed and emerging economies, can be interpreted in a similar fashion (Colpan and Hikino 2010; Khanna and Yafeh 2007).

The rise of local competitors is another major theme and highly relevant for the activities of multinationals, in particular in countries with great ‘psychic distance,’ which tended to be the case for most of the markets in question. Psychic distance is defined as the sum of factors preventing the flow of information from and to the market. Examples are differences in language, education, business practices, culture, and industrial development (Johanson and Vahlne 1977, 24). By exploiting their ownership advantages, such as access to knowledge, capital, and technology, Western multinationals held an advantage over local competitors. However, some of these competitors went into fierce competition with the foreign companies, benefitting from their superior knowledge of the local market and its (often informal) institutions. Other local competitors pursued a more cooperative strategy and succeeded in becoming valuable intermediaries between local culture and foreign firms (Lubinski; Lanciotti and Lluch; Lavista, in this volume). In this way, they opened up possibilities for knowledge transfer and were sometimes able to develop into independent competitors over time. The availability and willingness of local partners and the political context for foreign direct investment also influenced the decisions in terms of the degree of internalization of operations (Jones 2010), i.e., exporting, licensing, joint ventures, or wholly owned subsidiaries (Sluyterman and Bowens; Lanciotti and Lluch; Lavista, in this volume).
Local responsiveness is a feature that consequently became crucial for Western multinationals in developing markets. As entrepreneurs in these countries began catching up with the foreign first-movers, they were often particularly successful in responding to local tastes and preferences and also developed organizational forms well adapted to their local context. This created significant pressure for multinationals to increase the localization of their products and services as well as their operation – with some obvious variation depending on the sectors and host countries. For consumer-goods producers in particular, adaptation to local customs and tastes became crucial for market success (Sluyterman and Bowens; Lubinski; Johanson and Kao, in this volume). Localization also became necessary in human resource and production strategies – often partly in response to government or civil society pressures in the host country. At the same time, multinationals transformed their host economies and societies by introducing foreign products, production and distribution methods, and payment forms – changes that were not always welcome and sometimes rejected on moral grounds or because of nationalist sentiments (Lubinski; Taylor, in this volume).

Taken together, the contributions in the special issue show that the opportunities offered by today’s emerging markets and the challenges associated with taking advantage of them are far from being new or unique. Questions such as ‘How quickly can a market be expected to “emerge”?’ ‘How far will it go?’ ‘When will investments pay off?’ were already being asked by decision-makers in the nineteenth and twentieth centuries, with their expectations often proving overly optimistic – not dissimilar to today. Despite the somewhat different historical contexts, the way entrepreneurs and managers reacted to the resulting adversities in the past, whether and how patient investors ultimately benefitted from their continuous presence in certain markets and in which organizational forms tenacity was best achieved might provide valuable lessons for today’s multinationals aiming to translate potential into profits.

Acknowledgements

We would like to thank the German Historical Institute in Washington DC for generously funding the workshop ‘Translating Potential into Profits: Foreign Multinationals in Emerging Markets since the 19th Century,’ where these papers were first presented. We are also grateful to the other participants for their suggestions and comments; the reviewers for providing valuable feedback; the authors for patiently making the requested changes by reviewers and editors; and, last not least, Patricia Sutcliffe for her insightful comments and thorough copy-editing of the final versions.

Disclosure statement

No potential conflict of interest was reported by the authors.

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