

**Escape FDI and economic  
consequences:  
An institutional perspective**

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## **ABSTRACT**

Academic literature has increasingly shown escape foreign direct investment (FDI) to be a strategic motive used by firms investing abroad to diversify their risk to their home market. Internationalisation allows firms to mitigate the risk of being based in uncertain environments characterised by underdeveloped institutions and economic weakness (institutional voids), which are seen as comparative disadvantages. By expanding abroad, firms reduce their dependence on the home market for their revenues and profits. To date, most existing research has explored the characteristics, drivers and motivations for outbound FDI from emerging economies, but has paid relatively less attention to the economic consequences of such investments. The aim of this study is to gain an understanding of the economic consequences of escape FDI. Understanding the economic consequences of escape FDI will enable managers of South African multinational firms (MNEs) to develop and implement internationalisation strategies that create value, as measured by an increase in market capitalisation, for the firm.

Quantitative, explanatory research methods were adopted in order to gain new insights into the economic consequences of escape FDI. The study adopted a longitudinal, multi-industry design and was deductive in nature. The population was 85 firms, which were investigated over a 5-year period, with an interval between 2013 and 2018. The data was analysed using descriptive statistics followed by confirmatory regression analysis.

The key finding was that South African MNEs who invested in emerging markets, particularly in multiple host countries in Africa whilst adopting a “portfolio approach” to their international investments, delivered exceptional performance, creating significant value in the process. The secondary finding was that individual firms who either invested in emerging markets or developed markets created and destroyed value evenly, confirming existing literature that firms are heterogeneous and that a firm's place in time and space, and thus context, matters fundamentally.

The findings from this research add to the extant literature in the field of international business by introducing the “portfolio approach” to international investment strategy and performance. The implications for management is that firms need to understand their ownership advantages in designing and implementing international investment strategies because escape based FDI and related economic performance can have profound direct consequences for the firm itself, but indirectly on the wider community as a whole.

*Key Words:* Institutional theory, escape outward foreign direct investment, economic consequences, performance, ownership advantages

## **DECLARATION**

I declare that this research project is my own work. It is submitted in partial fulfilment of the requirements for the degree of Master of Philosophy (International Business) at the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other University. I further declare that I have obtained the necessary authorisation and consent to carry out this research.

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# TABLE OF CONTENTS

<b>ABSTRACT .....</b>	<b>ii</b>
<b>DECLARATION .....</b>	<b>iv</b>
<b>TABLE OF CONTENTS.....</b>	<b>v</b>
<b>LIST OF TABLES .....</b>	<b>viii</b>
<b>LIST OF FIGURES.....</b>	<b>ix</b>
<b>Chapter 1: INTRODUCTION TO THE RESEARCH PROBLEM .....</b>	<b>1</b>
1.1 Background .....	1
1.2 Introduction.....	1
1.3 Description of the Problem.....	8
1.4 Scope of the Research .....	9
1.5 Purpose of the Research .....	9
1.6 Conclusion.....	10
<b>Chapter 2: LITERATURE REVIEW .....</b>	<b>11</b>
2.1 Introduction.....	11
2.2 Outbound Foreign Direct Investment: Classic Theory .....	11
2.3 OLI Eclectic Paradigm and Internalisation Theory .....	13
2.4 The emergence of new theories: LLL and Springboard Theory.....	16
2.5 Institutional Theory .....	19
2.6 Escape Foreign Direct Investment to Other Emerging Markets and Performance .....	23
2.7 Escape Foreign Direct Investment to Developed Markets and Performance .....	27
2.8 Comparing performance of South African firms who invested in emerging markets to South African firms who invested in developed markets .....	32
2.9 Conclusion.....	35
<b>Chapter 3: RESEARCH HYPOTHESES.....</b>	<b>38</b>
3.1 Hypothesis 1 .....	38
3.2 Hypothesis 2.....	39
3.3 Conclusion.....	39
<b>Chapter 4: RESEARCH METHODOLOGY AND DESIGN.....</b>	<b>41</b>
4.1 Introduction.....	41
4.2 Choice of Methodology (Research Philosophy and Design).....	42
4.3 Unit of Analysis .....	43
4.4 Universe of Analysis (population) .....	43
4.5 Sampling Technique (Method and Size).....	43
4.6 Measurement Instrument .....	46

4.6.1	<i>Independent Variable(s)</i> .....	46
4.6.2	<i>Dependent Variable</i> .....	46
4.6.3	<i>Control Variables</i> .....	47
4.7	Data Gathering Process.....	48
4.7.1	<i>Research Instrument</i> .....	48
4.7.2	<i>Quality of data: Validity and reliability</i> .....	49
4.8	Data Analysis.....	50
4.9	Limitations in the Method and Data .....	53
4.10	Conclusion.....	55
<b>Chapter 5: RESULTS</b> .....		<b>56</b>
5.1	Introduction.....	56
5.2	Description of Sample Obtained.....	56
5.2.1	<i>Population</i> .....	56
5.2.2	<i>Results on reliability and validity of data</i> .....	57
5.2.3	<i>Data Transformations</i> .....	57
5.2.4	<i>Firms investing in emerging and developed markets</i> .....	58
5.3	Hypothesis 1: Descriptive Results at a Consolidated Level .....	59
5.3.1	<i>Descriptive results by share price</i> .....	59
5.3.2	<i>Descriptive results by market capitalisation</i> .....	60
5.3.3	<i>Statistical results of individual firm value creation or destruction by South African MNEs invested in either emerging markets or developed markets</i> .....	61
5.4	Hypothesis 2: Descriptive Results at a Consolidated Level .....	65
5.4.1	<i>Statistical results comparing total value creation or destruction by South African firms that invested in either emerging markets or developed markets</i> .....	67
<b>Chapter 6: DISCUSSION OF RESULTS</b> .....		<b>77</b>
6.1	Context of the Study .....	77
6.2	Escape Foreign Direct Investment to Emerging Markets and Performance .....	79
6.3	Escape Foreign Direct Investment to Developed Markets and Performance .....	85
6.4	Emerging Market versus Developed Market Performance .....	90
6.5	Additional Results.....	93
6.5.1	<i>Risk</i> .....	93
6.5.2	<i>Age</i> .....	94
6.5.3	<i>Size</i> .....	95
<b>Chapter 7: CONCLUSION</b> .....		<b>96</b>
7.1	Principal Findings .....	98
7.2	Practical Implications for Managers and Businesses .....	101
7.3	Limitations of the Study.....	104
7.3.1	<i>Unit of analysis</i> .....	104
7.3.2	<i>Currency and related impact</i> .....	105
7.3.3	<i>Longitudinal in nature</i> .....	105
7.3.4	<i>Motives</i> .....	105
7.4	Suggestions for Future Research .....	106
7.5	Conclusion.....	107
<b>REFERENCES</b> .....		<b>109</b>

<b>Appendix 1: Distribution of Firms by % Sales or Assets in Developed Markets</b>	<b>117</b>
<b>Appendix 2: Distribution of Firm Age .....</b>	<b>118</b>
<b>Appendix 3: Spread of Observations.....</b>	<b>119</b>
<b>Appendix 4: Residuals vs Fitted Observations Excluding Outliers .....</b>	<b>124</b>
<b>Appendix 5: Normal Q-Q Plot Excluding Outliers .....</b>	<b>125</b>

## LIST OF TABLES

Table 1: Developed countries as classified by the IMF .....	45
Table 2: Number of firms and percentage sales invested in developed markets.....	58
Table 3: Descriptive results for each dependent variable.....	59
Table 4: Creation or destruction of value by share price .....	59
Table 5: Creation or destruction of value by market capitalisation .....	60
Table 6: Hypothesis 1: Tobin's Q linear regression model fit .....	62
Table 7: Hypothesis 1: Return on assets linear regression model fit.....	63
Table 8: Hypothesis 1: Market capitalisation linear regression model fit .....	63
Table 9: Hypothesis 1: Share price linear regression model fit .....	64
Table 10: Hypothesis 1: Return on shareholders' funds linear regression model fit .....	65
Table 11: Change in market capitalisation between 2013 and 2018 by industry .....	65
Table 12: Change in market capitalisation between 2013 and 2019 by industry .....	66
Table 13: Linear regression on change in Tobin's Q.....	68
Table 14: Linear regression on change in return on assets .....	69
Table 15: Linear regression analysis on change in market capitalisation including all observations.....	70
Table 16: Linear regression model on change in market capitalisation excluding outliers .....	74
Table 17: Linear Regression on Change in Share Price .....	74
Table 18: Linear Regression on Change in Return on Shareholder's Funds.....	75



## LIST OF FIGURES

Figure 1: Residuals versus fitted model.....	71
Figure 2: Normal Q-Q plot .....	72
Figure 3: DFFITS plot of observations.....	73

# **Chapter 1: INTRODUCTION TO THE RESEARCH PROBLEM**

## **1.1 Background**

In April 2014, Woolworths made the unexpected announcement that it was buying struggling Australian department store David Jones for R21.4 billion, the largest foreign acquisition by a South African retailer to date. This announcement was surprising because Pick n Pay had tried to enter the Australian market twice and had failed dismally on both occasions. Analysts were sceptical, and rightly so; in 2018, Woolworths impaired part of its David Jones division by AU\$712.5 million (R7.2 billion, 33 per cent of the acquisition price). The firm's trading results said it all; profit before tax of AU\$63 million on AU\$2.2 billion sales, or 2.9 per cent (Woolworths Integrated Report, 2018). If one assumes a cost of capital of at least the prime lending rate of 10.25 per cent, the outcome is clear: the acquisition is a failure. The division generated insufficient profits to pay for itself. Performance had been deteriorating consistently over a number of years, which negatively affected the overall market value of the firm.

Why did Woolworths choose to invest in Australia, a low growth developed market? Why did it not choose an investment location in an emerging market? What influence did the South African institutional environment have on its choice of investment location?

## **1.2 Introduction**

According to the United Nations Conference on Trade and Development (UNCTAD), outbound foreign direct investment (FDI) from emerging markets rose from an insignificant US\$1 billion between 1980 and 1985 to a significant US\$409 billion in 2015 (Luo & Tung, 2018). Furthermore, emerging market multinationals have climbed up the rankings of the biggest corporations, as evidenced by the number of multinationals in the Global 500, from 69 in 2007 to 164 in 2017 (Luo & Tung, 2018).

The rapid rise and appearance of emerging market multinationals in recent decades on the global stage has attracted a significant amount of academic work. Their increasing importance in the global context will attract increasing scholarly attention and ignite debate around this new phenomenon (Hernandez & Guillen, 2018). The research has focused mainly on emerging market multinationals (EMNEs) rather than multinationals

from developed economies (DMNEs). It concentrates on their differences, including, but not limited to, characteristics, motives, ownership advantages (Luo & Tung, 2018; Ramamurti, 2012; Cuervo-Cazurra, 2012; Hennart 2012; Verbeke & Kano, 2015), mode of entry and location choices.

This is fuelling the debate about whether existing international business theory can be applied to EMNEs to explain this new phenomenon; whether existing theory needs to be modified or bounded, or whether new theories are required (Hernandez & Guillen, 2018).

Classic acknowledged international business theory and the bedrock of international business theory are based on Dunning's OLI eclectic paradigm (Dunning, 2001) and Rugman's FSA/CSA (internalisation) theory (Rugman, 2010). Both are anchored in the principles that a firm possesses ownership advantages and capabilities developed while competing in its home market (firm- and country-specific advantages) The firm internationalises to take advantage of market imperfections in the host country (location-specific advantages which includes market size, natural resources, infrastructure and labour costs). The nature of the ownership advantages are intangible, strong, transferable and sufficient to overcome barriers to entry. The main barrier to entry is liability of foreignness, a risk that arises from operating in a foreign location, whereby the firm is at a disadvantage to the local rivals (if any) because it does not know the norms and way of doing business. This is an inherent risk of internationalisation. The firm, having superior ownership advantages, overwhelms the local competition, as the local competition cannot compete effectively with the foreign entrant. Traditional ownership advantages include cutting-edge technology, recognised and established brands and managerial expertise.

Motives for foreign investment include vertical integration, whereby the firm invests abroad to gain a competitive advantage over factors of production. Such advantages include land or labour (natural resource seeking or efficiency seeking). The motivation for horizontal investment is to service the host market (market seeking) while maintaining operations in its home market (Hernandez & Guillen, 2018). In this instance, the firm will set up production facilities. The fourth classic motive for foreign investment is to obtain strategic assets, such as cutting-edge technology or well-established brands. Finally, firms internationalise not only to exploit their ownership advantages, but also to augment them (Dunning, 2001).

Location choice and mode of entry are based on the Uppsala model (University of Uppsala, Sweden). Academics observed DMNE internationalisation based on a logical sequence of steps related to an increasing commitment of resources. The process of internationalisation begins with direct exports. This is followed by exporting through agents. The firm then increases its commitment by setting up a sales subsidiary. The process culminates with substantial investment in a wholly owned subsidiary (internal) with production and marketing operations and related activities (Guillen & Garcia-Canal, 2009). The pace of investment and expansion is bounded by accumulated knowledge and experience as the firm learns to cope with the liability of foreignness and manage the associated risks. The inherent risk in the internationalisation process is low.

The firm's expansion path is simple and gradual; expanding on a country-by-country basis. This is based on psychic distance, beginning with similar countries (sociocultural distance, culture, language and norms) and expanding to more distant countries. However, organisational adaptability is low because of legacy structures and culture, whereby the firm suffers from path dependence and inertia. Finally, political capabilities are weak because firms operate in stable political environments (Guillen & Garcia-Canal, 2009).

Classic theory was developed based on scholars' observations of multinationals emanating from the developed world. Dunning, in particular, based his observations and theories on UK and US manufacturers and the labour productivity differential (Dunning, 2001) and its origins.

From the 1970s, a new phenomenon was observed: firms from developing countries were also making foreign investments. At the vanguard of the most recent wave are Latin American, Asian and Middle Eastern countries (including South Africa) (Hernandez & Guillen, 2018). These emerging market multinational enterprises (EMNEs) were not only making investments in other emerging markets, but also in developed markets. Scholars found this particularly intriguing. These EMNEs did not possess the same ownership advantages (cutting-edge technology or recognised brands) as their developed market counterparts and it appeared that their international expansion was driven by strategic motives that were different from those of developed market multinational enterprises (DMNEs). They internationalised at an accelerated rate and chose a more high-risk mode of entry, usually through alliances or acquisitions (Madhok & Keyhani, 2012; Guillen & Garcia-Canal, 2009).

In Buckley, Clegg, Cross, Liu, Voss, and Zheng's (2007) seminal empirical study of outward foreign direct investment by firms from China, a major finding was on political risk and choice of location. Chinese firms were choosing to invest in host countries with similar political and institutional environments to China. This indicated that EMNEs have a different and higher risk profile than expected, which is contrary to that found among developed market firms.

Scholars, such as Karnani (Contractor, 2013), would argue that some of these investments do not improve profitability and are, in fact, wasteful. They further argue that international expansion through acquisitions does not create value, but destroys shareholder value (Contractor, 2013).

Can existing international business theory explain this new phenomenon of emerging market multinationals, or are new theories required? This is the question that international business scholars were contending with (Mathews, 2006; Luo & Tung, 2007; Ramamurti, 2012, Amighini, Cozza, Giuliani, Rabellotti, & Giarda Scalera, 2015).

Ramamurti (2012) asked the question whether existing theories, developed through observing DMNEs, are adequate to explain the behaviour of EMNEs? International business scholars have two opposing views: one point of view is that EMNEs are a new phenomenon, with Mathews (2006) arguing that they can only be understood through new theory. Luo and Tung (2007) support this view; however, they insist that the OLI eclectic paradigm is still relevant, but bounded. Peng, Wang and Jiang (2008) clearly state that a new theory is required. The contrary view is that EMNEs are a new phenomenon, but they can be explained by existing theory. Vernon (1979) argues that existing theory, covering ownership advantages, location choice and internalisation (OLI), is sufficient (Ramamurti, 2012). Hernandez and Guillen (2018) argue that the core elements of classic theory are still valid, but they are bounded, and certain assumptions need to be modified.

Ramamurti (2012) weighed in on the argument by stating that the answer probably lies somewhere between the two contrary views of Mathews (2006) and Vernon (1979). EMNEs do have firm-specific advantages (FSAs), but that they are different from traditional FSAs. These include an ability to operate in difficult environments, a deep understanding of customer needs in emerging markets and the ability to make products economically. Ramamurti (2012) concludes by stating that developed market multinationals have had more time to accumulate capabilities and are at a different stage of evolution compared with immature emerging market multinationals. This

translates into DMNEs having more potent ownership advantages than EMNEs. Thus, the comparison between EMNEs and DMNEs' characteristics arises not just from country-of-origin effects, but also from different stages of evolution.

A further group argued that EMNEs might not have traditional firm-specific advantages (FSAs) or ownership advantages (Hennart, 2012), but they do have alternative ownership advantages. These non-traditional FSAs will allow them to internationalise. Internationalisation is bounded to economies of similar or lower levels of development in other emerging markets.

As the debates developed, scholars began to take increasing notice of home country conditions, country-of-origin effects and the role of institutions. They acknowledged that place in time and space, history and context matter (Barney, 1991), and that the institutional environment has a profound influence on strategic decision-making in emerging markets.

Whereas historical research has focused on DMNEs, institutions have been passively relegated to the background because DMNEs operate in environments that are not characterised by institutional voids and market constraints. The questions around what drove strategy and performance include conditions either within the industry (Porter's industry view, 1980), or within a firm (Barney's firm-based view, Barney, 1991). Peng, Wang and Jiang (2008) highlighted that a market-based institutional framework has been taken for granted.

Current research has begun to note of these home country differences in the literature because emerging markets are characterised by institutional voids and market constraints (Gao, Zuzal, Jones & Khanna, 2017). Gao et al.'s work brought home country effects to the forefront. Most presciently, institutional voids and market constraints are now highlighted by scholars as important. In Buckley, Clegg, Liu, Voss and Zheng's ground-breaking research on outward foreign direct investment by firms from emerging markets (China), the Scholars rounded off their arguments by stating, "firms, especially those from emerging markets, need to pay greater attention to the influence of home market institutions" (Buckley, et al., 2007, pg.31).

As early as 2007, Luo and Tung (2007) noted that emerging market multinationals were using international expansion as a strategy to mitigate home country institutional constraints or limited home markets through opportunity-seeking or strategic asset-seeking activities. Significant institutional voids include political obstacles, including, but not limited to, political instability, poor governance, opaque and uncertain regulatory

environments and poor protection of property rights (Luo & Tung, 2007). As a result, firms are pushed to escape these institutional voids and internationalise.

Guillen and Garcia-Canal (2009) have concentrated on motives, identifying macroeconomic factors and political volatility as key drivers of external investment by EMNEs, whereby the firm invests abroad to diversify its risk.

As EMNEs gained significance on the global stage, researchers have increasingly started to focus on institutions. Scholarly insights highlighted the fact that the formal and informal institutions – “rules of the game” (North, 1990) - significantly influence and shape strategic decision-making in emerging markets, particularly concerning investments abroad. These investments abroad impact the performance of firms operating in emerging markets, both foreign and domestic (Peng, Wang & Jiang, 2008).

The key question that Peng, Wang and Jiang (2008) asked is: How do institutions matter? They argued that “research with a focus on emerging economies helps lead to the emergence of an institution-based view of strategy” (Peng, Wang & Jiang, 2008, pg.921). Inherent in this statement is that a new theory is required. The importance of institutions, institutional theory, and strategy and institutional theory and international business has clearly begun to emerge as a significant topic within academia in the past 12 years.

By 2013, institutional theory had become a key strategic pillar in international business theory. Hoskisson, Wright, Filatotchev and Peng (2013) argue that institutional theory had become more relevant because of the nature of emerging markets and how their institutions evolve or develop (or lack thereof), highlighting factor markets and lack of infrastructure as key issues. Buckley noted: “Institutional theory offers considerable explanatory power in international business research because the external environment in which the firm operates, together with its internal resources and capabilities, shape to a considerable degree its competitiveness.” (Buckley, 2018, pg.206). This applies particularly to emerging markets. Therefore, the arguments, hypotheses and objectives of this research are grounded in institutional theory developed by North (1990).

Institutions and institutional theory are currently receiving a significant amount of scholarly attention in international business studies. Wang and Li (2018) base their arguments and hypotheses on institutional theory, dealing with host country institutional differences and their impact on the investment behaviour of foreign investors. Barnard

and Luiz (2018) propose that extensive outbound FDI results from fundamental changes to institutions.

Linking classic theory and institutional theory brings the current debates into focus; are EMNEs internationalising to exploit their specific ownership advantages or are they internationalising to escape the constraints and resulting disadvantages that arise from operating in institutional voids? (Stoian & Mohr, 2016)

In Cuervo-Cazurra and Ramamurti's 2017 paper on home country underdevelopment and internationalisation, escape-based internationalisation is directly tackled, noting that it is a strong motivation for a firm to escape from underdeveloped home country conditions and move to a more stable and attractive foreign location. Cuervo-Cazurra, Luo, Ramamurti and Hwee Ang (2018) argue that EMNEs are more likely to invest in countries with stable institutions (proxy for developed markets). As scholars have investigated EMNEs in greater detail, home and host institutional environments have come to be viewed as fundamental and are prominent in the context of foreign investment decisions. Cuervo-Cazurra and Ramamurti (2017), Buckley (2018), Cuervo-Cazurra, Luo, Ramamurti, and Hwee Ang (2018), and Barnard and Luiz (2018) all focused on institutional environments, specifically underdeveloped institutions and market constraints and how the presence and significance of institutional voids and market constraints are fuelling escape-based internationalisation. Escape-based internationalisation as a strategic motive and the economic consequences for the firm have not been adequately addressed in the literature.

Therefore, there is a need for empirical research on the relationships between home country institutional environment, outward escape foreign direct investment by South African multinationals to both developing and developed markets and the economic consequences of such investment decisions on the overall performance of the firm.

To date, most existing research has explored the characteristics, drivers and motivations for outbound foreign direct investment from emerging economies, but has paid relatively less attention to the *consequences* of such investments. Amighini et al. (2015) note that future research should address this limitation, specifically on the *economic consequences* of EMNEs' investments... "these *consequences require investigation on economic as well as socio-environmental grounds*" (page number not available). The paucity of research relating to this topical phenomenon and especially the economic consequences of escape-based FDI has motivated this research



### 1.3 Description of the Problem

The rapid rise and emergence of emerging market multinationals and their increasing importance in the context of the global economy in recent decades as a new phenomenon has resulted in a significant amount of academic work regarding the characteristics, motives location choice and mode of entry between EMNEs and developed MNEs (DMNEs).

In recent years, as scholars have investigated the new phenomenon of EMNEs, home and host country institutional environments have come to be viewed as fundamental and are prominent in the context of foreign investment decisions. Peng, Wang and Jiang (2008), Buckley (2018), Cuervo-Cazurra, Luo, Ramamurti and Hwee Ang (2018), Cuervo-Cazurra and Ramamurti (2017), and Barnard and Luiz (2018) all focus on institutional environments, specifically underdeveloped institutions and how the impact of institutional voids are driving internationalisation. These “push” factors are fuelling escape outbound FDI to developing and developed markets.

These young MNEs do possess FSAs (although they are non-traditional in nature). They have a deep understanding of customer needs in their home countries. EMNEs have acquired the ability to create and market the right products and services for their home market. EMNEs have learnt to operate in conditions characterised by institutional voids, and by overcoming these challenges are able to expand abroad to similar emerging markets where their FSAs are sufficient to enable these EMNEs to perform.

However, when they internationalise to developed markets, they are faced with increased and daunting competition from DMNE rivals. DMNEs have superior FSAs, relative to EMNEs, because they have had more time to accumulate these capabilities while competing successfully in their home markets. Therefore, EMNEs would face significant barriers to entry in attempting to enter developed markets, which could result in business failure (Deng, Yang & Van Essen, 2018). The consequences of investing in developed markets could be catastrophic.

Would the South African multinational be better advised to stay at home, where it has a deep understanding of its home environment. Should the MNE invest abroad in similar emerging markets, characterised by similar institutional environments, compared with investing abroad in developed markets?

## **1.4 Scope of the Research**

Research has shifted focus from the differences in characteristics between EMNEs and DMNEs (Hernandez & Guillen, 2018) to the differences in home country conditions and their institutional endowments, including market constraints (Gao, Zuzal, Jones & Khanna, 2017). Institutions and institutional theory are currently receiving significant scholarly attention (Wang & Li, 2018). Barnard and Luiz have concentrated on how underdeveloped institutions and market constraints are “pushing” firms to invest abroad, to escape their home country institutional and market conditions. To date there is a paucity of research on the economic consequences of escape FDI.

The scope of the research is based on South African multinationals that have invested in emerging markets, developed markets or both to gain an understanding of the economic consequences of escape FDI. Gaining an understanding of whether this motive for internationalising has had positive or negative economic consequences for the firm.

## **1.5 Purpose of the Research**

The objective of this research is to determine whether the firm would be better advised to invest in similar emerging markets, where the EMNE may have the required FSAs to compete effectively and consequentially more likely to create value. Alternatively, the firm could invest in more stable environments in the developed world, where the firm will be faced with increased competition from DMNEs with potentially more potent FSAs, and thus the firm is more likely to destroy value. Therefore, the primary objective is to determine the economic consequences of escape-based internationalisation strategies by South African MNEs.

The business need for this research is that it has important implications for managerial practice (Cuervo-Cazurra, Ciravegna, Melgarejo, & Lopez, 2018). The nature of the issue that arises is whether the motivation to invest abroad is a good or a bad strategic decision for the firm. Would the firm have been better advised to remain in its home country or to invest in a similar emerging countries. These countries have similar institutional voids and risks but management has a greater understanding of the institutional environment and market. The firms also have the requisite ownership advantages to enable it to perform consistently and enhance its value.

Alternatively, would it be beneficial to escape to a more stable environment? This is critical information for managers of firms that want to develop and implement internationalisation strategies (Cuervo-Cazurra et al., 2018).

The theoretical need is based on a lack of empirical research on the economic consequences on the value of the firm due to escape-based outward FDI as a motive for internationalisation. Current literature mainly explores the motivations for outward FDI from emerging economies and focuses on the differences between the characteristics of MNEs from developed economies and emerging market multinationals. Specifically, the nature and differences in ownership advantages, location choice and mode of entry are dealt with. This is evidenced by the academic works by Barnard and Luiz (2018) and Cuervo-Cazurra and Ramamurti (2017) as well as the academic literature cited in this research and in the literature review. Therefore, this empirical research will add to theory by testing the economic consequences of escape FDI by looking at whether the decision to invest abroad to escape home country institutional and market constraints have been value-adding or value-destroying strategies for South African multinational firms.

## **1.6 Conclusion**

This research will investigate how the South African institutional environment, characterised by institutional voids and market constraints, shapes and influences the investment location of outbound FDI. The research will focus on the economic consequences of escape FDI as a strategic choice made by managers of South African multinational enterprises. The research will study whether escape FDI to emerging and developed markets was a value-creating or value-destroying strategy at firm level. The study will also consider whether it is better for the firm to escape to other similar emerging markets or to developed markets, which are considered more stable. Escape FDI as a strategic motive for outbound FDI can have far-reaching economic and social consequences that can affect not just the firm, but all stakeholders directly or indirectly.

## **Chapter 2: LITERATURE REVIEW**

### **2.1 Introduction**

The purpose of this study is to understand the economic consequences of escape FDI. The following literature review will explore the classic motives for outbound foreign direct investment and how the field of international business study has evolved to include new emerging theories. New theories have been posited from observing this new breed of EMNE. As EMNEs gained in significance on the world stage, so scholars have focused more intently on this phenomenon.

Alongside Mathews' LLL framework (Mathews, 2006) and Luo and Tung's (2007) Springboard theory, Institutional theory has emerged as the dominant new theory, formulated whilst observing EMNEs. Institutional theory forms the foundation of this study and it is highly relevant in explaining the motive of outbound escape FDI, whether to emerging markets, to developed markets, or both.

### **2.2 Outbound Foreign Direct Investment: Classic Theory**

What determines the success or failure of multinational firms? (Peng, Wang & Jiang, 2008). What drives MNE strategy and related performance? (Peng et al., 2008). These are the fundamental questions about international business that require thought and deliberation. Emerging market firms possess ownership advantages (firm and country-specific advantages) and internationalise to exploit and augment these competitive advantages in other geographical locations. They overcome barriers to entry such as liability of foreignness and overwhelm local competition in the process, who lack sufficient ownership advantages to compete (Dunning, 2001; Stoian & Mohr, 2016).

These ownership (O) advantages are developed in the home market and then transferred abroad to specific countries based on the host country's specific endowments, known as location (L) advantages, through outward foreign direct investment. In the process, the firm exploits opportunities by internalising (I) market imperfections (Rugman, 2010). These assumptions about firm and country-specific advantages (ownership advantages), location advantages and internalisation of opportunities form the basis of Dunning's OLI eclectic framework and Rugman's internalisation theory (FSA/CSA matrix), which are the bedrock of international business studies. The OLI eclectic and Internalisation theories are widely recognised

as classic theory; developed whilst observing multinationals from developed economies.

Traditional ownership advantages consisted of firm-specific advantages comprised of proprietary cutting-edge technology, well-established brands and managerial expertise, as well as country-specific advantages. Dunning (2001) argued that certain country-specific factors, such as natural factor endowments and industry market structure, could be transformed into ownership advantages (Rugman, 2010), which could be transferred abroad. Locational advantages arise from host country advantages, including infrastructure, natural resources (such as when a licence to operate a mine is awarded to a firm, the locational advantage is transformed into an ownership advantage), market size (Rugman, 2010) and strategic assets, which are characterised as either market based or resource driven (Buckley, 2018).

Scholars argued that having these ownership advantages still did not explain why firms would conduct activities outside their national boundaries. Would it not be less complex and less risky to sell these rights (as mentioned above) in the open market instead of exploiting these ownership advantages internally? (Dunning, 2001). Why produce when you could outsource? Guillen and Garcia-Canal (2009) argue that multinationals exist because certain economic conditions make it desirable and profitable for them to internalise activities and conduct operations in a foreign location. When uncertainty around supply or asset specificity (or both) related to vertical expansion is high, internalisation is desirable. Vertical expansion is associated with natural resource-seeking and efficiency-seeking. When accessing new markets through horizontal expansion and the risk of appropriation of know-how or technology is high, internalisation is preferable (market seeking to service the new market without abandoning the home market) (Hernandez & Guillen, 2018). Profitable when related to transaction costs arising from host country endowments (capital, land and labour), (Rugman, 2010).

The fourth motive for international expansion is strategic asset seeking (technology and brands), which is a vital motivation for both DMNEs and EMNEs (Dunning, 2001; Hernandez, & Guillen, 2018).

Hernandez and Guillen (2018) cite three other compelling motivations for outward foreign direct investment. Firstly, monopolistic or oligopolistic behaviour forces competing firms to follow one another into foreign markets. Secondly, through product lifecycle dynamics by which new products penetrate the home market and expand

abroad to increasingly less developed economies. Finally, incrementally increasing their commitments and investments as they gain knowledge and experience and learn to cope and operate in foreign locations, overcoming barriers to entry such as liability of foreignness, known as the Uppsala model of internationalisation. Further attributes of the Uppsala model are that it is gradual, and low risk in nature, with the firm expanding into one country at a time, beginning with similar countries in terms of sociocultural distance (psychic distance) (Guillen & Garcia-Canal, 2009) and slowly expanding outwards to other countries, bounded by accumulation of knowledge and experience.

The classic mode of entry is based on the Uppsala model. It can be summarised as gradual, internal, staged and inherently low risk. Firms begin with imports, graduating to importing through agents, followed by establishing a sales subsidiary and then upgrading their investment to a full production and marketing operation (Guillen & Garcia-Canal, 2009). The Uppsala model originated from the University of Uppsala, Sweden, by scholars observing multinationals from developed economies.

### **2.3 OLI Eclectic Paradigm and Internalisation Theory**

Based on scholars' observations of multinationals from developed economies, two dominant theories evolved, which formed the foundation of classic theory in international business literature. The OLI eclectic paradigm and internationalisation theory emphasise the possession of proprietary or ownership advantages (FSA/CSA), market power or oligopolistic advantage as pre-requisites for going global. Internalisation theory takes place in an integrated multinational structure in a unified way, which gains criticality when the market is inefficient (Guillen & Garcia-Canal, 2009). Both theories are firm-level constructs. Both the OLI eclectic paradigm and internationalisation theory are based on the assumption that the firm must possess certain ownership advantages before it can internationalise. Internalisation theory is based on the firm exploiting market imperfections across borders (Rugman, 2010). Certain activities are internalised, which results in above normal returns and thereby increasing the firm's value (Aybar & Ficici, 2009).

In the 1980s, a new phenomenon was observed: firms in developing countries were also making foreign investments. The collapse of the Soviet Union and the concomitant rise of the Washington Consensus together with neoliberal globalisation, led to liberalising policies and pro-market reforms. Driven by the laws of the free market, a

relaxation of exchange controls and an open-door policy, this new global context sparked the rise of emerging market multinationals (EMNEs).

A new era of globalisation also heralded the rise of financialisation (Marais, 2013). The consequence of which was that access to capital was no longer solely confined to developed market countries. For the first time, EMNEs had access to capital similar to their DMNE counterparts (Contractor, 2013), enabling them to strategically engage in outbound foreign direct investment activities, particularly foreign acquisitions and greenfield operations.

The rise of globalisation was simultaneously accompanied by the spread of the Internet and advancements in information technology, which gave EMNEs access to developed nation technology. These shifts had ramifications that were game changing. Previous tacit corporate knowledge (in the minds of managers and engineers) was codified. Knowledge was now written into protocols, expert systems, software and manuals, which made it easier to be obtained, discerned and disseminated. By the 1990s, new business models were being created. This included business platforms, which enabled the disaggregation of the supply chain. Between 1982 and 2011, offshoring, outsourcing and international licensing were the fastest-growing modes of international business (Contractor, 2013), which made EMNEs more aware of new opportunities in the international business landscape to exploit.

By 2004, foreign direct investment (FDI) to developing countries rose to US\$172 billion, representing 32 per cent of global FDI, according to the United Nations Conference on Trade and Development (UNCTAD, 2004), with acquisitions being the main driver. The emergence of emerging economies as significant destinations for FDI flows as well as their increasing importance within the context of the global economy began to attract scholarly attention.

Scholars began to observe EMNEs and compare EMNEs and their related behaviours to DMNEs. Extant literature focused on the differences in three key dimensions; ownership advantages (FSAs and CSAs based on the specifics of the home country), motivations for outbound FDI and mode of entry (Amighini et al., 2015). Fundamental differences between EMNE and DMNE behaviour ignited scholarly debate.

The key questions being whether existing theories, developed through observing DMNEs (Buckley, Elia & Kafouros, 2014), are adequate to explain the new phenomenon of EMNEs. Whether existing theory is relevant but requires certain

modifications to the underlying assumptions, or whether new theories are required altogether (Ramamurti, 2012; Hennart, 2012).

Opposing arguments emerged: Amighini et al. (2015) and Mathews (2006) state on the one hand that EMNEs are seen as an entirely new phenomenon. They can only be understood through new theory. While on the other hand, scholars argued that existing theory is sufficient to explain EMNE behaviour. Theories such as the OLI classic paradigm (Aybar & Ficici, 2009; Xie & Li, 2017; Hernandez & Guillen, 2018) are relevant. Questions swirled around existing theory and its ability to explain behaviours of these new emerging market multinationals. Scholars found EMNE outbound FDI into developed markets particularly vexing (Dunning, 2001).

Certain scholars have argued that EMNEs lack ownership advantages (Madhok & Keyhani, 2012; Williamson & Wan, 2017), specifically FSAs. While other scholars argued that they do possess ownership advantages, they have just not been seen before. These new firm specific advantages are different in nature from traditional firm specific advantages (Guillen & Garcia-Canal, 2009; Ramamurti, 2012; Cuervo-Cazurra & Genc, 2008; Verbeke & Kano, 2015; Li, Yi & Cui, 2017; Ramamurti & Hillemann, 2018). These include an ability to manufacture products at extremely low prices, the ability to operate in difficult environments, political and networking skills, and a deep understanding of customer needs (Cuervo-Cazurra & Genc, 2008; Ramamurti, 2012; Kale & Singh, 2017; Li, Yi & Cui, 2017). This suggests that the underlying assumptions in the classic paradigm require modification to include these non-traditional ownership advantages that EMNEs are exhibiting. In the process, extending the type of ownership advantages that qualify as being new (Madhok & Keyhani, 2012).

Hennart (2012) states that emerging market multinationals build new capabilities by exploiting locational advantages in their home markets and convert these country-specific advantages to ownership advantages through learning and innovation. These new capabilities can be deployed in expanding abroad, in particular to similar countries with the same or lower levels of development. Williamson and Wan (2017) confirmed this, identifying dynamic capabilities as crucial attributes required to execute this strategy successfully. This implies that existing theory is adequate but bounded.

Based on their analysis of Chinese EMNEs, Williamson and Wan (2017) complement this by arguing that the boundary conditions of ownership advantages need to be expanded to include the context of institutional voids and the home-country institutional environment. This seems to violate the assumptions of classic theory, implying that the



scope of extant theory needs to be expanded to incorporate newer theoretically relevant aspects, such as the role of institutions (Madhok & Keyhani, 2012).

## **2.4 The emergence of new theories: LLL and Springboard Theory**

EMNEs may have strategies that we have not seen with DMNEs, such as investing abroad to bring back technologies and/or brands to exploit in their home market (Ramamurti, 2012). Some of these strategies may be due to differences in the stage of evolution. EMNEs are immature MNEs in the early phase of internationalisation, whereas DMNEs are mature MNEs (Kale & Singh, 2017). Therefore, EMNEs have had less time to accumulate FSAs than their DMNE counterparts. That does not disqualify them from possessing FSAs, they are just non-traditional in nature. This will have a resultant impact on their motives, such as investing abroad to learn and acquire expertise, and access the requisite resources to build their capability library. In so doing, these EMNEs strengthen their position in their home market (Kale & Singh, 2017).

Classic theory presupposes that MNEs possess FSAs before they internationalise, yet MNEs are investing abroad precisely to obtain FSAs that are unavailable in their home countries (Luo & Tung 2007; Rugman, 2010). This observed behavior questions the appropriateness of current theories and requires new explanations and resultant theory (Madhok & Keyhani, 2012). Theories are constantly evolving as empirical studies confirm or fail to confirm the hypotheses derived from those studies (Hernandez & Guillen, 2018). As a direct result, new theoretical perspectives have emerged.

The linkage, leverage and learning (LLL) framework emerged based on Mathews' (2006) observations of a group of Asia Pacific MNEs (dubbed "Dragon Multinationals") emanating from Singapore, Hong Kong, Taiwan and South Korea. These MNEs, lacking ownership advantages, overcame their resource deficiencies by partnering with external networks (linkage) to access external resources (leverage). Repeated application of the linkage and leverage process resulted in learning (Wang et al., 2014). Hennart (2012) also noted that FSA-poor MNEs are investing abroad to acquire the requisite ownership advantages.

The firms adopt an outward global orientation. Motivated by latecomer disadvantages, characterised by resource and capability voids relative to their DMNE counterparts, the firms engage in strategic asset seeking to compensate for their deficiencies in technological knowledge, brand recognition and managerial expertise. Concurrently,

the firm engages in opportunity-seeking behaviours to exploit existing resources (Wang et al., 2014).

Springboard theory (Luo & Tung, 2007, 2018) correlates with Mathews' LLL framework. Both are associated with capability and resource deficiencies and latecomer disadvantages. (Wang et al., 2014). The main premise of Springboard theory is that the firm uses international expansion as a springboard, mostly to acquire strategic resources and alleviate institutional and market constraints at home, as well as to overcome barriers to trade in advanced economies. A further motivation is to exploit competitive advantages and market opportunities in other countries. Both Springboard theory and LLL theory support the notion that firms are internationalising for multiple motives simultaneously, being asset-seeking (resources), opportunity seeking as well as resource exploitation (Luo & Tung, 2018).

LLL and Springboard theory imply that EMNEs use internationalisation to overcome home-country disadvantages at both the country and the firm level. At the core of these disadvantages are the underdeveloped home factor markets for technology, managerial expertise and skilled labour (Wang et al., 2014). EMNEs are further disadvantaged and incapacitated by the pervasiveness of institutional voids and political risks, recognising that context matters.

Hoskisson, Wright, Filatotchev and Peng (2013) note that a country's endowed factor markets determine its economic opportunities. North (1990) recognised that institutions influence and shape business activities. Cuervo-Cazurra and Ramamurti (2017) reaffirmed how the home country influences a firm's internationalisation strategies. Most notably are those EMNEs, whose home countries are characterised by institutional voids and how underdeveloped institutions and economic weakness incite their internationalisation. Home country underdeveloped institutions and market constraint are viewed as comparative disadvantages.

Thus emerged Institutional theory, with the escape-based view. The motivation for EMNEs to internationalise is to overcome weak institutional environments and market constraints (Witt & Lewin, 2007).

DMNEs internationalisation process is simple, incremental and low risk. Commitment of resources is internal and staged (exports lead to final investment in a wholly owned subsidiary), linked to accumulation of knowledge and experience. Pace of expansion is gradual and location choice is path dependent based on a country-by-country approach. Firms enter new markets that they feel are familiar based on psychic

distance and gradually enter new markets that are progressively greater in psychic distance (Guillen & Garcia Canal, 2009).

Juxtaposed to DMNEs internationalisation process and mode of entry, EMNEs expansion is rapid, radical, aggressive and high risk. Internationalisation is driven by the motivation to overcome their latecomer status and catch up. The preferred mode of entry is through greenfield investments or acquisitions. Both strategies are high-risk (Luo & Tung, 2007, 2018). According to Kale and Singh (2017), the top three motives for acquisitions are to acquire advanced technology, gain access to talent and management expertise and acquire established brands.

Psychic distance matters less due to globalisation and resultant connectivity. EMNEs may internationalise based on differences between countries rather than similarities. Their expansion path can be dual in nature, with simultaneous investments in both developed and developing markets. Amighini et al. (2015) noted that outward FDI for market seeking, efficiency seeking and resource seeking flows to developing economies, whereas strategic asset seeking restricts investments to developed markets.

In Buckley et al.'s (2007) groundbreaking research, a key finding was on political risk. The research highlighted an increasingly positive relationship between host country political risk and Chinese OFDI (based on an analysis of Chinese SOEs). They propose that institutional factors may have induced a perverse attitude to risk, which is contrary to that found among developed market firms. Chinese firms prefer host countries with high political risk to those with low political risk (Ramamurti & Hillemann, 2018).

There has been much scholarly debate about the differences between DMNEs and EMNEs and the applicability of classic theory, particularly pertaining to ownership advantages, motivations for investing abroad and mode of entry. One criticism of OLI theory is that it does not explain the opportunities for the evolution, development and creation of new firm capabilities over time (Amighini et al., 2015).

Ramamurti (2012) points out that scholars must not presume that EMNE behaviour is motivated exclusively because they emanate from emerging markets. Firms' ability to exploit resources depends upon their place in time and space (Barney, 1991). Place in time and space and thus consequentially, context matters fundamentally in firm strategies related to internationalisation. The industry in which the firm operates, stage of evolution of the EMNE and the global context for internationalisation have a

profound effect in shaping the internationalisation strategy, which has a cascading effect on speed of internationalisation, location choices and mode of entry (Ramamurti, 2012). Barney (1991) confirms this by stating that firms within an industry may be heterogeneous.

EMNEs are heterogeneous (Amighini et al., 2015) and generalisations are insufficient. As the research intensified, EMNEs exhibited some behaviours that had not been seen before and that required new theories. Classic OLI theory, Internalisation theory (FSA/CSA matrix), Mathews' LLL framework, Luo and Tung's Springboard theory, and North's Institutional theory have emerged as the dominant theories in the field of international business literature.

Peng, Wang and Jiang (2008) note that institutional theory has become one of the most insightful theories when investigating and probing emerging markets and the most frequently drawn upon, due to its usefulness when seeking to gain a better understanding of the unfolding MNE behaviours and competition in emerging markets.

## **2.5 Institutional Theory**

In the 1990s and 2000s there was a shift in academic writing towards the role of institutions. The institutional perspective has both macro- and microeconomic foundations (Dunning & Lundan, 2008). Institutions set the "rules of the game" both within society and the organisation (North, 1990). Institutions may not only impose constraints on the actions of the firms; they might even affect managers' perceptions, and possibly influence managerial behavior towards strategies an MNE might pursue (Dunning & Lundan, 2008).

Cuervo-Cazurra, Luo, Ramamurti and Hwee Ang (2018) state that home country conditions re-emerged in the 2000s as an important topic as EMNEs gained more significance on the world stage, including their weak market-supporting institutions. Emerging markets have less stable political systems, poorer enforcement of regulations, lower levels of institutional development and higher prevalence of corruption (Cuervo-Cazurra & Ramamurti, 2017).

A defining feature of emerging markets is their lower level of economic development, evidenced by less sophisticated innovation systems, weak infrastructure and capital markets (Cuervo-Cazurra & Ramamurti, 2017). EMNEs tend to be based in countries characterised by low to middle incomes and weak institutional environments (Madhok

& Keyhani, 2012) and institutional voids, where market-facilitating institutions are either absent or function ineffectively (Enderwick, 2016).

Scholars have argued that institutions are more than background conditions (Gao, Zuzul, Jones & Khanna, 2018). They directly influence and shape the strategic actions taken by a firm (Buckley et al., 2007). Peng, Wang and Jiang (2008) argue that a market-based institutional framework has been taken for granted; however, there is increasing appreciation for how home country institutions significantly shape the strategy and performance of both foreign and domestic firms in emerging markets.

Emerging markets are characterised by institutional voids that are symbolised by unsophisticated customers, underdeveloped markets for capital and labour, and weak infrastructure. They are plagued by the absence or underdevelopment of institutions that enable effective markets, which includes government mechanisms that protect property rights, prevent corruption and ensure the rule of law and ensure supportive infrastructure (Marano, Tashman & Kostova, 2017).

This leads to important negative consequences for emerging market firms. Their environments do not enable them to create and develop sufficiently high-quality competencies to compete effectively with their DMNE counterparts (Kale & Singh, 2017). These include high-quality technical and highly skilled labour competencies.

This negatively affects the facilitation of market transactions, resulting in constraints and challenges that are different from developed markets, most notably dealing with uncertainty. Uncertainty in the environment, including regulatory uncertainty, corruption and potential political shocks pose a threat to firms, which have to be constantly managed (Gao, Zuzul, Jones & Khanna, 2017). They negatively affect competition, as operating in institutional voids increases the cost of doing business, leading to a competitive disadvantage.

Political risk deals with uncertainty about the political environment, whereas corruption and regulatory uncertainty centre on how the rules are interpreted and enforced (Cuervo-Cazurra, Ciravegna, Melgarejo & Lopez, 2018).

Internationalisation allows firms to mitigate the risk of being based in uncertain environments characterised by underdeveloped institutions and economic weakness, which are seen as comparative disadvantages. By expanding abroad, they reduce their dependence on the home market for their revenues and profits (Cuervo-Cazurra et al., 2018), intimating that a push factor is driving internationalisation (Kale & Singh, 2017).

Crucial inputs may not be available in their home markets; therefore, one strategy available to EMNEs to respond to their home country constraints is to expand into foreign markets through acquisitions (Deng & Yang, 2015).

Luo and Tung (2018) confirm this motivation, clarifying that EMNEs use international expansion as a strategic choice to circumvent the institutional and market constraints they face at home and to acquire the resources they need to compete globally. Shi, Sun, Yan and Zhu (2017) highlight location choice in the existing literature. They state that international expansion by EMNEs is to avoid institutional and market constraints, by investing abroad in developed economies (Shi, Sun, Yan & Zhu, 2017).

Early research by Kim, Kim and Hoskisson (2010) investigated the role of institutions in shaping company strategy in the context of business groups and transition economies. Related studies involved the study of EMNEs by Luo and Tung in 2007 and Ramamurti in 2012, with the latter focusing on *how* institutions affected the foreign investments by EMNEs (Cuervo-Cazurra, Luo, Ramamurti & Hwee Ang, 2018). Buckley (2018) states that the influence of the institutional framework plays a pivotal role in the internationalisation of domestic firms.

Early scholarly attention favoured the macro “task environment” view, focusing on external economic factors such as environmental endowments or munificence, technological change and competitive forces, which influence the firm’s strategy (Ahlstrom et al., 2014). More recently, scholars have focused on sociocultural factors and their relationship with strategic choices, including risk-taking (Buckley, Chen, Clegg & Voss, 2016), noting that culture plays a significant role in shaping the firm’s strategy.

This resonates with institutional theorists who maintain that institutions not only include formal laws and regulations, but also include informal rules and norms, specifically the preconscious cognitive and ideational elements that are embedded in culture and are widely accepted by society (Ahlstrom et al., 2014). This is fundamental because managers make the strategic decisions. Corporate executives have to be competent, skillfully manipulating their strategic choices within their domestic institutional context, creating the space and the freedom to pursue the international strategies of their own choosing (Luo & Tung, 2007, 2018).

According to Wang et al. (2014), domestic institutional constraints have psychological consequences for these executives. They may exhibit behaviours associated with self-doubt or overconfidence within their firms, which affects decision-making, both positively and negatively.

For DMNEs, political risk is a significant indicator when identifying location choice, preferring host countries with lower levels of political risk. In contrast, EMNEs choose to engage in host countries with weak institutions and higher levels of political risk. Buckley et al. (2016) have noted that the international business literature has identified risk-taking as a significant competitive advantage for EMNEs over their DMNE counterparts.

Risk-taking is a strategic choice, including scope, scale and speed of internationalisation, choice of location and mode of entry, all are based on managers' perceptions of their firm's capabilities and perceived ownership advantages.

Guillen and Garcia-Canal (2009) argue that by operating in institutional voids, these managers develop non-traditional capabilities, such as political skills, which are particularly valuable, enabling EMNEs to manage unstable governments and navigate rapid changes in the regulatory environment. EMNEs learn to manage effectively in uncertain and risky environments. This may give EMNEs an advantage over DMNEs in emerging markets because their DMNE counterparts have not developed such capabilities operating in environments that are not characterised by weak institutions.

This is supported by the World Governance Indicator (WGI) scores, which in 2007 showed that developed countries had much higher scores than their emerging country counterparts (Cuervo-Cazurra & Genc, 2008), indicating higher levels of governance, a key measure of institutional strength or weakness.

Cuervo-Cazurra and Ramamurti (2017) highlight how the development of this capability converts a country's comparative disadvantage to a firm-specific advantage. Having developed these non-traditional capabilities, EMNEs can then exploit these firm-specific advantages (FSAs) in other emerging markets (Contractor, 2013).

What emerges from the literature is that there are two diametrically opposing views that fuels escape based internationalisation by EMNEs. Managers of firms in emerging markets learn to operate and compete successfully in their home countries. Through the process of learning, the firm develops non-traditional FSAs. These non-traditional FSAs can be transferred to similar environments (in other emerging markets). These FSA's enable the firm to create a competitive advantage over their DMNE counterparts and consequently outcompete them (Cuervo-Cazurra, Luo, Ramamurti & Hwee Ang, 2018).

Traditional motives would include natural resource seeking, efficiency seeking and market seeking. Home country and institutional challenges are not recognised as insurmountable, but as opportunities to create new products and services that can be deployed to other emerging markets (Cuervo-Cazurra & Ramamurti, 2017).

The contrarian view is that compared to their peers who perceive the uncertainty in the environment as a challenge that needs to be overcome, these managers perceive uncertainty as a threat (Gao, Zuzul, Jones & Khanna, 2017). These managers then seek strategies to limit their exposure to the home market (Barnard & Luiz, 2018). This implies that these firms' managers have inherently different risk profiles. Cuervo-Cazurra and Ramamurti (2017) highlight that there is a significant motivation for firms to escape constraining home country conditions and move to a more attractive and stable foreign location(s), in developed markets.

According to Madhok and Keyhani (2012), EMNEs understand the importance and urgency of diversifying geographically, and must learn to compete globally as well as to escape institutional constraints at home.

Stoian and Mohr (2016) noted that home country institutional voids have a significant influence on escapist FDI from emerging markets. Therefore adopting an institution-based view is vital when observing and examining the determinants of outbound FDI from emerging markets.

Firms find the weak institutional environment stifling, problematic and uncompetitive and they are pushed to invest abroad to escape and avoid these institutional limitations and market constraints (Marano, Tashman & Kostova, 2017). As the environment becomes more challenging, evidenced by increasing costs of doing business, firms look to reduce their exposure to their home country and diversify risk by investing abroad. Traditional motives may be presented as market seeking or strategic asset seeking, but the true motive may be institutional escape: escape foreign direct investment (Barnard & Luiz, 2018).

## **2.6 Escape Foreign Direct Investment to Other Emerging Markets and Performance**

Cuervo-Cazurra and Genc (2008) were one of the first scholars to note home country institutional learning by emerging market firms. These firms had the ability to survive and even flourish in weak institutional environments. They were able to transform home



country competitive disadvantages into firm-specific advantages. These FSAs gave EMNEs a competitive advantage over their DMNE rivals. Cuervo-Cazurra and Ramamurti (2017) coined this innovation-based internationalisation. This competitive advantage applied to EMNEs operating in similar environments with similar institutional weaknesses, namely in other emerging markets. Innovation-based or institutional learning-based internationalisation to other emerging markets led to better outcomes as evidenced by firms' positive performance (value creation).

The nature and relationship between home country environment, internationalisation and performance were studied by Cuervo-Cazurra, Ciravegna, Melgarejo and Lopez in 2018, by studying a relatively large sample of Latin American firms based in Brazil, Argentina, Chile and Peru (536 publicly traded firms). Their findings confirm that firms operating in emerging markets with higher levels of uncertainty, specifically higher political risk and corruption, perform better than their local competitors do. This finding is attributed to what the authors term an "uncertainty management capability". This is developed by managing high political risk and uncertainty at home that can be used abroad (Cuervo-Cazurra, 2016). The authors expand this dynamic capability to include adaptability, flexibility and resilience.

Firms in emerging markets learn to compete effectively in their home markets and transform this country-level disadvantage to a firm-specific advantage (building capabilities), which they can transfer and exploit in other emerging markets, thus leveraging these capabilities.

The above dynamic capabilities are further expanded to include ambidexterity skills (Contractor, 2013). Included in this skill set is a willingness to be flexible and adaptable and possess a greater tolerance of ambiguity. Guillen and Garcia-Canal (2009) identify these FSAs as institutional entrepreneurial capabilities that enable the firm to operate effectively. The existence of these individual level behavioural traits strongly correlates with improved performance in developing countries.

Gao, Zuzul, Jones and Khanna (2017) complement these arguments by arguing that reputation is also an FSA, with resilience being one of the key attributes (prominence and perceived quality are the other two key attributes that make up reputation). They further argue that reputation can contribute to a firm's mitigation of risk of operating in institutional voids as well as capitalising on opportunities, thereby extending competitive advantages.

Firms also rely on country-specific advantages to construct their firm-specific advantages. Firms have access to inputs, which allows them to build advantages such as new products and business models, particularly in export markets where they have a better understanding of the local conditions and a less sophisticated consumer. These inputs could include institutional advantage, natural resources and low-cost labour, which they have privileged access to and is unavailable to competing firms. Having developed the firm's capabilities, they then transfer and exploit them in other emerging markets where they have a further advantage over DMNEs, who are accustomed to developing products for a more sophisticated consumer (Cuervo-Cazurra & Ramamurti, 2017).

A key feature of this institutional management capability is that firms learn to manage multiple dimensions. This has further value when internationalising because inherent in internationalising is that there are multiple dimensions, such as unpredictability and complexity, that are required to be managed when operating abroad. Underdeveloped institutions require managers to become self-reliant and improvisational to overcome overbearing regulations, emphasising their adaptability and flexibility to manage and cope with changing conditions. Developing these skills further enables these managers to manage international activities.

Host country institutional environments are not homogeneous, but heterogeneous and differ according to different levels of economic development, which, in turn, influences the strategic decisions of foreign investors (Wang & Li, 2018). The implication of this is that the host country's institutional environment has a significant influence on location choice for multinationals. Cuervo-Cazurra, Ciravegna, Melgarejo and Lopez's (2018) final finding was that firms perform better when they expand regionally into countries that tend to have similar institutional environments and are of lower psychic distance. However, firms may discount cultural distance in their strategic deliberations if the market potential is compelling enough (Lebedev, Peng, Xie & Stevens, 2015).

A spillover effect of learning to operate in uncertain and risky environments is that EMNEs perceive risk differently from DMNEs, allowing them to invest abroad in host countries that are distinct from their home country (Cuervo-Cazurra & Ramamurti, 2017). A prime example is South Africa's MTN, which entered Uganda to provide mobile phone network services. At the time, Celtel (a subsidiary of Britain's Vodafone) enjoyed a monopoly. Over time, MTN was able to build a subscriber base 22 times larger than its main rival, Celtel, attributable to its skill and experience in navigating and negotiating economic and political risks (Cuervo-Cazurra & Genc, 2008).

Amighini et al. (2015) confirmed that EMNEs' motives for investing in developing economies abroad are predominantly resource seeking, efficiency seeking and market seeking, and that Chinese firms tended to invest in countries with weak institutional environments because the economic rents from resource-seeking activities are easier to elicit in weaker institutional environments with a greedy elite and authoritarian regimes. Ramamurti and Hillemann (2018) supported this view, finding that Chinese firms prefer host countries with high political risk to countries with low political risk. However, according to Deng & Yang (2015), EMNEs investing in risky environments appreciate high government effectiveness, which ensures that their investments are protected.

Zhang et al. (2018) studied Chinese pharmaceutical firm's mergers and acquisitions (M&A) activity between 2008 and 2016 and found that value-chain extension (entering new markets or extending the sales channel) and technology-seeking M&A was positively related to the firm's performance. This further supports the argument that investing in other emerging markets abroad may be value creating.

To articulate the argument; despite being immature multinationals, EMNEs do possess FSAs, though they are non-traditional in nature. They have a deep understanding of customers and the ability to create and market the right feature-price mix of products and services to unsophisticated customers. They have also developed capabilities that have allowed them to transform home country comparative disadvantages into firm-specific advantages, such as adaptability, flexibility and resilience, enabling them to survive and perform as well as navigate political and regulatory risks. EMNEs have learnt to operate in uncertain conditions and have a higher risk tolerance than their developed country counterparts. They do not perceive home country deficiencies as limitations, but as challenges to overcome in the normal course of business that expands their strategic opportunity set, including international expansion.

They escape the constraints and limitations of the home market by investing abroad in other emerging markets with similar institutional characteristics, uncertainties and risk profiles to take advantage of opportunities in the host country. They are able to overcome the liability of foreignness disadvantage and compete effectively with local and multinational rivals because they have developed effective non-traditional FSAs. These firms have been efficient in converting country-specific locational advantages into ownership advantages that are transferable and effective in similar emerging markets. Their international investments into other emerging markets are more likely to create value. This leads to hypothesis 1a:

Hypothesis 1a: Escape based FDI by South African firms to emerging markets is positively correlated to performance (value creation).

## **2.7 Escape Foreign Direct Investment to Developed Markets and Performance**

EMNEs tend to be based in countries with low to middle incomes and weak institutions (Madhok & Keyhani, 2012) and lower levels of development. These lower levels of development result in weaker resource munificence of home countries in emerging markets than in developed markets (Estrin, Meyer & Pelletier, 2018). This includes the education system, which is responsible for developing the technical, managerial and language skills of the labour market.

The main motives for escape foreign direct investment are to avoid underdeveloped institutions and markets and market constraints, such as stagnant or limited domestic markets (Stoian & Mohr, 2016; Buckley, 2018) and institutional voids (Enderwick, 2016). It is primarily a response by a firm to institutional misalignment between the country of origin and its corporate goals (Kobrak, Oesterle & Rober, 2018). Managers perceive the environment to be a threat and managers invest in more attractive and stable foreign locations, in developed markets, to escape constraining home country conditions (Cuervo-Cazurra & Ramamurti, 2017).

Kobrak, Oesterle and Rober (2018) argue that the current business environment in terms of the global context plays an influencing role in escape FDI than currently acknowledged by international business literature. This indicates that these investments are not just motivated by home country disadvantages.

These international investments will be in more stable, developed economies. The idea originated in the fields of finance and the political economy by observing the cross-listing of firms from emerging economies to advanced economies (Cuervo-Cazurra et al., 2018).

In other words, the managers take the firm abroad to avoid precarious conditions at home, including restrictions, and institutional misalignment and fragility (Cuervo-Cazurra & Ramamurti, 2017; Shi, Sun, Yan & Zhu, 2017; Buckley, 2018). Compared with their peers who perceive the uncertainty in the environment as a challenge that needs to be overcome, these managers perceive uncertainty as a threat (Gao, Zuzul, Jones & Khanna, 2017), leading them to limit their exposure to the home country

(Barnard & Luiz, 2018). This implies that these firms have inherently different risk profiles. This type of foreign investment may imitate or mimic strategic asset seeking or market seeking in developed markets, and thus may be difficult to differentiate from conventional FDI (Buckley, 2018).

Firms are concerned about political stability, which includes the absence of violence. Managers fear sudden changes in policies and renege on existing contracts (Cuervo-Cazurra & Genc, 2008). In South Africa, the deliberations on the changes to the Mining Charter are eroding local and foreign investor confidence.

Firms are concerned about regulatory quality, particularly market-unfriendly policies. Holistically, firms do not like overregulation because it limits freedom of operation and imposes constraints; however, they appreciate regulatory quality as it reduces uncertainty. Poor regulations increase uncertainty and introduce distortions into investments (Cuervo-Cazurra & Genc, 2008). In South Africa, the Broad-Based Black Economic Empowerment Act 46 of 2013 (B-BBEE Act) has effectively distorted the labour market, leading to negative perceptions about the country's workforce. The Act can also be seen through the lens of protectionism, as job reservation and related quotas are codified. This has had an adverse effect on competitiveness, especially when EMNEs' own operations are not protected (Stoian & Mohr, 2016).

Rule of law is important to international investors, particularly with regard to property rights. In South Africa, the issue of expropriation of land without compensation is particularly relevant. The government is proposing changes to Article 25 of the Constitution to give life to this policy.

Corruption is a concern for foreign investors because it increases the difficulty and cost of operations. Corruption increases risk because it can cause reputational damage that negatively impacts the performance of the firm (Stoian & Mohr, 2016). In South Africa, corruption and state capture have taken the country to the brink of bankruptcy (Cuervo-Cazurra & Genc, 2008).

Political instability, lack of regulatory quality, disregard for rule of law and corruption are all evidenced in South Africa, fuelling the desire to escape. South Africa could be characterised as a country with high levels of corruption that tends to experience low levels of economic growth (Stoian & Mohr, 2016). South Africa experienced stagnant growth and a "lost decade" during the Zuma era from 2009 to 2018. Stagnant growth limits firms' domestic expansion (Stoian & Mohr, 2016) and by implication, performance, which drives outbound FDI.

Cuervo-Cazurra and Ramamurti (2017) note that underdeveloped institutions result in an increase in operational costs and a reduction in investment. Together with lower levels of economic and institutional development, less stable political systems, prevalence of corruption and weak enforcement of regulations, the cumulative effect is that the EMNE operates in a volatile environment, and at a comparative disadvantage to its DMNE counterparts. Thus, the firm feels the need to “safeguard” itself against these risks and the need arises for a “spare business” (Barnard & Luiz, 2018). The push factor is a desire to escape the environment and move to safer havens, which can lead to capital flight, whereby the firm is simply used as camouflage for the international transfer of wealth (Buckley, 2018). Sharp deteriorations in the institutional environment may trigger institutional escape (Cuervo-Cazurra et al., 2018).

EMNEs tend to have weaker and less robust FSAs than their DMNE counterparts in terms of sustainable above-average returns (Madhok & Keyhani, 2012), such as proprietary technology or brands (Ramamurti & Hillemann, 2018). EMNEs are also smaller in size (Cuervo-Cazurra & Genc, 2008). Their competitive advantages in advanced economies and resultant economic gains are usually efficiency or natural resource based rather than monopoly based (Madhok & Keyhani, 2012).

This could be due to stage of evolution, whereby DMNEs have had more time to accumulate strong FSAs. However, EMNEs do have one particular ownership advantage that may enable escape FDI: they have the ability to exploit capital market imperfections by transforming a country-specific advantage into an ownership advantage (Amighini et al., 2015, Buckley, 2018).

EMNEs therefore may have weaker FSAs due to being younger MNEs relative to DMNEs, which translates into a latecomer disadvantage. A further disadvantage stemming from being a latecomer, is that EMNEs may lack effective managerial capabilities. Their managerial capabilities, having been developed operating in a less competitive context, may not be sufficient or good enough when operating in more advanced and competitive economies, leading to a deficit in managerial capabilities (Madhok & Keyhani, 2012).

Compounding their FSA weaknesses and latecomer disadvantages, EMNEs face additional obstacles and challenges, especially when investing in advanced economies. These additional barriers to entry arise simply because the firm originates from an emerging economy (country of origin), being legitimacy or reputational challenges, referred to as liability of emergingness (Madhok & Keyhani, 2012) and

liability of origin (Marano, Tashman & Kostova, 2017). Liability of emergingness is associated with a number of country-of-origin disadvantages, which collectively leads to an institutional deficit (Madhok & Keyhani, 2012) that translates into competitive disadvantages, resulting in erosion of the competitiveness of EMNEs.

Deng and Yang (2015) state that escape FDI is further rationalised when there are ample markets and distribution channels in place upon acquisition. Their research on nine emerging market countries, including South Africa, found that EMNEs investing in advanced countries have gained access to established brands and they internationalise through acquisition. In short, EMNEs go to developed markets to acquire strategic assets.

In emerging markets, crucial imperfections are often found in their financial markets. Capital market imperfections include intra-business cross-subsidisation, which gives EMNEs access to cheap capital that acts as a catalyst for firms to invest abroad (Buckley, 2018). EMNEs may also dominate in their home country markets, creating further financial resources (Madhok & Keyhani, 2012).

EMNEs therefore have significant resources available for acquisitions. Access to ample funding reduces the financial and commercial risks associated with international investment projects. This enables the acquisition of less profitable brand- and technology-seeking assets, especially in developed markets through subsidisation (Buckley, 2018). Contractor (2013) goes further by stating that some acquisitions are wasteful, have loaded EMNEs with high debt, do not improve profitability and ultimately destroy shareholder value. This was observed in more than half of the transactions reviewed. Lebedev, Peng, Xie and Stevens (2015) point out those prior studies have shown that M&As decrease the shareholder value of the acquiring firm over the long term.

Another interesting factor Lebedev, Peng, Xie and Stevens (2015) found, is that EMNEs bid higher for targets in developed markets than acquirers from DMNEs, leading to higher premiums being paid for their acquisitions. Overall, their findings suggest a high level of management hubris. Furthermore, acquisition is the quickest way for a firm to grow. They postulate that CEOs' pay is significantly correlated to firm size, indicating that managers have strong incentives to make their firms larger, as measured by sales. Hoskisson, Wright, Filatotchev and Peng (2013) observed Chinese MNEs' outbound FDI to developed markets based on incentives to overcome home country factor markets and institutional voids. These investments failed.

Stoian and Mohr (2016) questioned the type of ownership advantages that influence the relationship between regulatory voids and escape FDI from emerging markets. When there is a misalignment between a firm's strategy and resource requirements and home-country institutions, it opts to escape, but this does not answer the question regarding the type of FSAs required to escape successfully. Estrin, Meyer and Pelletier (2018) argue that deficiencies in home-country munificence results in competence gaps in firms, where deficiencies in the education system result in weak human capital development.

Therefore, EMNEs have weaker FSAs, face challenges of liability of origin and emergingness, which places them at a significant disadvantage to DMNEs. This results in higher liability of foreignness, which is daunting when they enter developed markets (Estrin, Meyer & Pelletier, 2018). They further argue that home-country endowments are weaker in emerging markets than in developed markets, thereby exacerbating the barrier to entry into developed markets. Compounding this is that they face formidable competition from rival DMNEs. These DMNEs have vast experience and powerful FSAs from competing successfully in their home markets. They have developed sophisticated products for sophisticated customers, have reputable brands, management expertise and experience in high-income distribution channels, all associated with markets where consumers have relatively high incomes (Estrin, Meyer & Pelletier, 2018). Finally, when EMNEs invest in developed markets with liberalised economies, the number of business rivals increases and competition intensifies (Deng, Yan & Van Essen, 2018).

Deng, Yan and Van Essen (2018) note that firms increase the risk of organisational overstretch and business failure if they invest in countries that are significantly different from their home country because they lack the required FSAs to compete effectively. They lack essential FSAs such as cutting-edge technology and established brands together with the appropriate level of management expertise and internationalisation experience. The results of their study suggest that outbound FDI is an undesirable strategy for EMNEs, with negative consequences for the firm's value. Therefore, escape FDI by EMNEs to developed markets will most likely destroy firm value. This leads to hypothesis 1b:

Hypothesis 1b: Escape based FDI by South African firms to developed markets is negatively correlated to performance (value destruction).



Hypothesis 1: Escape based FDI by South African firms to emerging markets is positively correlated to performance whilst escape based FDI by South African firms to developed markets is negatively correlated to performance.

## **2.8 Comparing performance of South African firms who invested in emerging markets to South African firms who invested in developed markets**

Place in time and space and the global context for internationalisation matter (Barney, 1991). Culture plays a paramount role, because managers make the strategic decisions. Managers have to be competent in order to create the space and the freedom to pursue the international strategies of their own choosing (Luo & Tung, 2007, 2018). Domestic institutional constraints have psychological consequences for managers, which affects their decision-making (Wang et al. 2014). Managers may perceive the uncertainty in their environment differently. This will influence and shape their internationalisation strategic decisions. Managers may perceive the uncertainty in the environment as a challenge to overcome, whereas other managers may perceive the environment as a threat (Gao, Zuzul, Jones & Khanna, 2017).

Emerging markets such as countries in Africa, and China, are enormous markets with over two billion potential consumers, making them extremely attractive. They offer bountiful opportunities for South African firms to exploit their existing resources (Wang et al., 2014). However as discussed above, they are replete with institutional voids. Curevo-Cazurra & Ramamurti (2017) identify the defining features, being less stable political systems, ambiguous regulations, lower levels of institutional development, the prevalence of corruption and weak infrastructure. They are characterised by weak institutions, especially lacking in government mechanisms that protect property rights (Marano, Tashman & Kostova, 2017).

A key finding in Buckley et al.'s (2007) study related to risk and risk tolerance. Chinese firms were selecting host countries to invest in with similar institutional and risk profile. Amighini et al. (2015) confirmed this finding. They noted the propensity of Chinese firms to invest in countries characterised by weak institutions. The strategy for these affiliated Chinese firms is to negotiate where there are authoritarian regimes and greedy elites, enabling the firm to manipulate the host environment to extract economic rents, resulting in exceptional performance. These strategies are possibly mimicked by

managers of South African firms who have a higher risk tolerance, and diversify their home country risk by investing in other emerging markets.

Cuervo-Cazurra, Ciravegna, Melgarejo & Lopez (2018) found that firms operating in emerging markets with higher political risk and corruption perform better than their local competitors do. This is because firms in emerging markets learn to compete effectively in their home markets.

They build their capability library by learning. In the process they develop dynamic capabilities. These new non-traditional FSAs, such as a deep understanding of the customer needs or attributes such as resilience are complimented by flexibility and adaptability, and especially a greater tolerance for ambiguity (Contractor, 2013). Guillen and Garcia-Canal (2009) identified these FSAs as entrepreneurial capabilities, the presence of which strongly correlated with improved performance in developing markets.

Curevo-Cazurra, Luo, Ramamurti, and Hewee Ang (2018) support these findings. They note that through the process of learning, the firm develops non-traditional FSAs, which can be transferred to other similar environments where they will have a competitive advantage over their local and DMNE rivals and consequently outcompete them.

Their market dominance in South Africa has allowed them to accumulate significant financial resources (Madhok & Keyhani, 2012). This places further resources at their disposal for making acquisitions and undertaking greenfield projects, which has enabled their expansion (Buckley, 2018).

These firms transform country-level disadvantages into firm-specific advantages, which they can then transfer and exploit in other emerging markets. These firms expand regionally into other emerging markets with similar institutional environments (Cuervo-Cazurra, Ciravegna, Melgarejo & Lopez, 2018). They face little to no international competition and are able to overwhelm the local competition who cannot compete effectively.

They operate in multiple host countries where they have achieved economies of scale, gaining in scale and scope which has enable them to diversify geographical risk effectively. They have diversified across Africa. They have augmented their ownership advantages (Dunning, 2001) and exploited the opportunities that have arisen because of their place in time and space (Barney, 1991). The result is that these firms have maintained their oligopolistic and even monopolistic positions in most of the host

countries in which they operate in, capturing economic rents in the process that sustain phenomenal performance.

Other scholars, such as Cuervo-Cazurra and Ramamurti (2017) argue that underdeveloped home country conditions is a strong motivation for firms to escape to a more stable and attractive location. Cuervo-Cazurra, Luo, Ramamurti and Hwee Ang (2018) argue that EMNEs are more likely to invest in developed markets with stable institutions. Shi, Sun, Yan and Zhu (2017) supported these arguments. They highlight location choice in the existing literature, stating that EMNEs international expansion is to escape home institutional and market constraints by investing in developed economies.

EMNEs tend to have weaker and less robust FSAs than their DMNE counterparts (Madhok & Keyhani, 2012). They lack cutting-edge technology and recognized brands (Ramamurti & Hillemann, 2018). The consequence of this is that these EMNEs will not be able to generate sustainable above-average returns in developed markets easily. Their competitive advantage in developed markets are efficiency based or natural resource based, rather than monopoly based (Makhok & Keyhani, 2012).

Capital market imperfections found in emerging markets, including intra-business cross-subsidisation, gives EMNEs access to cheap capital that acts as a catalyst to invest abroad through acquisition or greenfield projects (Buckley, 2018). Buckley (2018) goes on to note that because of ample access to cheap funding, the commercial and financial risks associated with international investment are reduced. Buckley is arguing that bountiful funding may lead to bad decision-making, evidenced by the acquisition of less profitable brand and technology-seeking assets. Contractor (2013) is more candid. He states that some acquisitions are wasteful, increases debt, decreases profitability and ultimately destroys value.

One has to ask the question why a firm would want to sell a strategic asset if it is generating above average sustainable market returns. Lebedev, Peng, Xie and Stevens (2015) found that EMNEs bid higher for targets in developed markets than their DMNE rivals did, leading to higher premiums being paid for acquisitions. Lebedev, Peng, Xie and Stevens (2015) also found there to be the existence of perverse incentives and a high level of management hubris. Acquisition is the most expeditious way to grow a firm, and they posit that executive pay is positively correlated to firm size. Therefore, it is not surprising that Lebedev, Peng, Xie & Stevens (2015) found that the majority of acquisitions by EMNE firms destroyed value.

Deng, Yan & Van Essen (2018) found that when EMNEs invest in developed markets, the number of rivals increases and competition intensifies. The findings of Deng, Yan and Van Essen's (2018) work suggest that escape FDI is an undesirable strategy for EMNEs. It has negative consequences for firm value. These findings are predicated on the fact that these EMNEs lack the essential FSAs such as cutting-edge technology and established brands to generate sustainable above average returns. A lack of managerial expertise may increase the firm's risk of organizational overstretch and business failure because they lack ownership advantages that would enable them to compete effectively. The outcome of this is that unlike their EMNE counterparts who invested in other emerging markets and who were able to generate economic rents, these EMNEs generate returns commensurate with competitive markets. This leads to hypothesis 2:

Hypothesis 2: South African firms who invested in emerging markets will have created more value than South African firms who invested in developed markets

## **2.9 Conclusion**

From the 1980s onwards, the global context changed with the financialisation of the world and the advancement of the Internet. Access to capital and liberalising economies fuelled the rise of the emerging market multinational. Their increasing prominence on the world stage began to attract scholarly attention. Scholars debated whether this new phenomenon required new theories to explain their characteristics and behaviours or was classic theory sufficient. Certain scholars argued that existing theory was sufficient while other scholars argued that new theory was required. The literature focused on the differences between EMNEs and their DMNE counterparts, concentrating on differences in ownership advantages, motives, location choice, speed of internationalisation and mode of entry. Observed EMNE behaviour was different from that of DMNE behaviour.

Literature progressed and expanded with ever-increasing attention on EMNEs. Scholars noted that time and space and consequentially context mattered. Country of origin, stage of evolution, industry and the global context of internationalisation entered the debates.

Existing classic theory, such as Dunning's OLI eclectic paradigm (Dunning, 2001) and Rugman's FSA/CSA matrix (Rugman, 2010) were found to be relevant, but required adaptation around the assumptions. Ownership advantages now included non-

traditional ownership advantages, such as political skills and the ability to produce the right product/price mix for the home market. However, these ownership advantages were found to be not as potent as DMNE ownership advantages, such as cutting-edge technology and established brands.

New theories emerged; most notably Luo and Tung's Springboard theory (2007) and Matthews' LLL theory (2006). Institutional theory was the third leg in the tripod of new prominent theory. Based on North's (1990) "rules of the game", scholars observed that home country natural munificence and conditions were driving certain behaviours. Institutions are more than background conditions (Gao, Zuzul, Jones & Khanna, 2018); they directly influence and shape the strategic actions taken by a firm (Buckley et al., 2007).

Home country institutions, or lack thereof (institutional voids), and market constraints elicited two opposite responses. Firms develop an "uncertainty management capability", constructed by managing political risk and uncertainty in the home market that can be used abroad (Cuervo-Cazurra, 2016). They learn to compete effectively in their home market, where management views these institutional voids and market limitations, not as constraints, but as obstacles to overcome. These firms, having developed non-traditional ownership advantages while operating in the home market, transfer these advantages to other emerging markets and in the process diversify their exposure to the home country.

These firms exploit the opportunities in the host environment. The requisite ownership advantages and general absence of local or DMNE competition enable these EMNEs to compete effectively and even thrive. They are able to escape successfully, creating value in the process.

Conversely, contrarian management view their home country institutional voids and market limitations as constraints. They perceive the underdevelopment of institutions, prevalence of corruption and weak enforcement of regulations as significant obstacles, which harms their competitiveness and puts them at a comparative disadvantage to their DMNE counterparts (Cuervo-Cazurra & Ramamurti, 2017). They feel the need to hedge against the home country market by diversifying their risk. They are pushed to escape the environment and move to safer havens by internationalising to developed markets.

They are faced with significant barriers to entry and DMNE counterparts with vast experience and superior ownership advantages. The number of business rivals

increases and competition intensifies (Deng, Yan & Van Essen, 2018). This strategy increases the risk of organisational overstretch and potential business failure. Deng, Yan and Van Essen (2018) suggest that this escape-based outbound FDI to developed markets is not a desirable strategy for EMNEs, which may have negative consequences on the firm value.

Two main themes can be gleaned from the literature. The first theme focuses on the differences between EMNE and DMNE characteristics and their behaviours. The second theme concentrates on the differences in EMNE and DMNE context, including country of origin, industry, stage of evolution and global stage of internationalisation. Nested within the second theme are institutional and market constraints, and how they influence and shape the firm's international investment strategy.

Should the firm escape to another emerging market, characterised by a higher risk profile and institutional voids, but with less competition? In this strategy, the firm will operate in an environment that it is familiar with, and the likelihood of succeeding is higher. Alternatively, should the firm escape home country institutional and market constraints and invest in a developed market, characterised by increased competition and DMNE rivals with more potent ownership advantages? In this strategy, the firm is faced with a different risk profile, being more intense competition and the likelihood of creating value is diminished.

The economic consequences of such investment decisions can have crucial consequences for the firm. Success may lead to growth with positive outcomes individually and for associated stakeholders. Failure may have dire consequences, even resulting in firm failure and loss of employment. This can have devastating effects on individuals, their families and even the wider community where the firm is located.

Therefore, the need to understand the economic consequences of escape-based outbound foreign direct investment is critical for managers who are mandated with making international investment decisions. The intention and outcome of this research is to gain that understanding and has motivated this study.

## Chapter 3: RESEARCH HYPOTHESES

The current literature mainly focuses on two themes of outbound FDI by multinationals. The first theme is concerned with differences in characteristics between emerging market multinationals and developed market multinationals. The focus is significantly on ownership advantages, choice of location, mode of entry and pace of internalisation, coupled with their different motivations for internationalising.

The second theme centres on the differences in institutional environments between emerging market multinationals and developed market multinationals and their respective strategic responses to conditions in the home market. Emerging market multinationals are characterised by the presence of institutional voids whereas developed markets are not.

One strategic response by EMNEs that operate in environments that constrain them in the home market, is to internationalise to escape the comparative disadvantages of operating in the home market. Stoian and Mohr (2016), Cuervo-Cazurra and Ramamurti (2017), Buckley (2018), Cuervo-Cazurra, Luo, Ramamurti, and Hwee Ang (2018), and Barnard and Luiz (2018) all focus on institutional environments and escape-based FDI as a motive to internationalise. Cuervo-Cazurra and Ramamurti (2017) highlight that there is a significant motivation for firms to escape constraining home country conditions and move to a more attractive and stable foreign location(s).

Until recently, the literature has not focused significant attention on to the *economic consequences* of such investments. Escape-based internationalisation as a strategic motive and the economic consequences for the firm have not been adequately addressed in the literature.

Therefore, the purpose of this research is to understand the economic consequences of escape-based outbound FDI by South African multinationals on overall firm performance. Has the strategic choice to invest abroad to escape home country institutional and market constraints been value-adding or value-destroying for the firm.

### 3.1 Hypothesis 1

The first hypothesis considers the absolute relationship between outbound FDI and overall firm performance, and tests whether escape-based outbound FDI creates or destroys value at a firm level as measured by share price and market capitalisation.

Based on a study of escape-based investment by Chinese firms, Deng et al. (2018) found that firms that invest in environments that are fundamentally different from their home country conditions increase the risk of business failure, which adversely affects the firm performance.

- *Hypothesis 1:* Escape based FDI by South African firms to emerging markets is positively correlated to performance whilst escape based FDI by South African firms to developed markets is negatively correlated to performance.
- *Hypothesis 1a:* Escape-based FDI by South African firms to emerging markets is positively correlated to performance (value creation).
- *Hypothesis 1b:* Escape-based FDI by South African firms to developed markets is negatively correlated to performance (value destruction).

### **3.2 Hypothesis 2**

The second hypothesis considers the relative performance of outbound FDI by South African MNEs. South African MNEs have developed capabilities by operating in their home country, which enables them to escape. They transfer and exploit these capabilities in other emerging markets where they will be competitive (Cuervo-Cazurra & Ramamurti, 2017). Conversely, South African MNEs that invest in developed markets to escape home market constraints face daunting competition from rival DMNEs that possess superior capabilities and will therefore not be as competitive and perform relatively poorly.

- *Hypothesis 2:* South African firms who invested in emerging markets will have created more value than South African firms who invested in developed markets

### **3.3 Conclusion**

Investment location by South African MNEs can have far-reaching implications for the firm and the resultant strategy is fundamentally influenced by manager's perceptions of risk.

Managers of South African MNEs who perceive the home environment constraints as obstacles to overcome, are likelier to implement emerging market internationalisation strategies. Having acquired the required FSAs to perform in similar institutional



environments to the home market, the economic consequences of such internationalisation is expected to be value creating.

Managers who perceive the home market institutional constraints as threats to be mitigated, are more likely to take the firm abroad to developed markets, which they discern the environment to be more stable. Escape based outbound FDI may be an undesirable strategy for a firm (Deng et al., 2018), which can lead to overstretch and a loss of competitiveness with negative consequences on overall firm performance. This internationalisation strategy is more prone to be value destroying.

## Chapter 4: RESEARCH METHODOLOGY AND DESIGN

### 4.1 Introduction

The empirical study was quantitative in nature. It used an archival secondary data strategy to obtain longitudinal data on the performance of South African multinational companies that invest abroad. This intended to gain an understanding on whether escape-based outbound FDI created or destroyed value at a firm level. The secondary intention was to gain an understanding on whether the firm would have been better advised to remain in its home market or invest in similar environments, other than investing abroad in developed markets.

A confirmatory test was initially performed to prove that firms that invested in developed markets generally destroy value, whereas firms that decided to remain within the South African market or invest in other emerging markets are inclined to create value. The overall firm performance, the dependent variable, was statistically hypothesised to outbound FDI, the independent variable. Following on from the confirmatory test, a regression analysis was performed to determine whether firm value was created or destroyed, then a further regression analysis was performed to identify whether it is better to invest in emerging or developed markets.

- *Hypothesis 1:* Escape based FDI by South African firms to emerging markets is positively correlated to performance whilst escape based FDI by South African firms to developed markets is negatively correlated to performance.
- *Hypothesis 1a:* Escape-based FDI by South African firms to emerging markets is positively correlated to performance (value creation).
- *Hypothesis 1b:* Escape-based FDI by South African firms to developed markets is negatively correlated to performance (value destruction).
- *Hypothesis 2:* South African firms who invested in emerging markets will have created more value than South African firms who invested in developed markets.

The rest of this chapter will provide the framework for the strategy and design of the research to confirm the hypotheses above. It contains the methodology, population, unit of analysis, measuring instrument, data gathering process, data analysis and limitations.

## **4.2 Choice of Methodology (Research Philosophy and Design)**

The philosophy for the proposed empirical research is positivism, as the outcome of the research is to answer the question and provide an explanation regarding the relationship between South African outbound FDI and firm performance. Positivist methodology is directed at explaining relationships and attempts to identify causes which influence outcomes (Scotland, 2012). According to Saunders, Lewis and Thornhill (2016), it promises unambiguous and accurate knowledge, which is uninfluenced by human interpretation or bias.

The empirical study adopted a longitudinal, multi-industry research design (Carayannis & Alexander, 2002) and was deductive in nature. This was because the hypotheses were tested based on the literature on escape-based outbound foreign direct investment and the economic consequences of this strategic decision on overall firm performance. The intention of the research was to extend and contribute to the current body of theory by examining economic performance related to escape-based outbound FDI in the South African context.

Data was collected on firm performance, including Return on Assets, Return on Shareholders' Funds, Tobin's Q (Market Value of Equity, Debt and Total Assets), Market Capitalisation and Share Price on all qualifying South African multinationals listed on the Johannesburg Stock Exchange in order to determine value creation or value destruction at firm level, between 2013 and 2018. The five measures of profitability were used to test value creation or destruction as well as relative performance. An analysis was performed to gain insight into whether escape-based outbound FDI created or destroyed value and whether the firm would have been better advised to remain in its home market, or invest in other emerging markets, instead of investing abroad in developed markets. Relationships are hypothesised to be positively correlated based on the literature on institutional theory. Conclusions were arrived at based on the data analysed; hence the research was an explanatory study.

Confirmatory regression analysis was used in this explanatory research. To obtain longitudinal data, the focus was on firms listed on the Johannesburg Stock exchange of South Africa (JSE) in all five years during the 2013 to 2018 period, but with intervals from 2013 and 2018. In line with the research philosophy of positivism, a quantitative research approach is necessary to address the variables in this study, being outbound FDI and firm performance. Furthermore, an archival research strategy associated with this quantitative approach will be employed.

### **4.3 Unit of Analysis**

The empirical study was based on the meso-level unit of analysis, which is the firm. Firms engaged in outbound FDI activities were selected based on the qualifying criteria discussed below.

A review of acquisitions by emerging market multinationals by Buckley, Elia and Kafouros (2014), stated that they collected firm-level data. The unit of analysis for this explanatory empirical research will be the listed firms in South Africa as the research is concerned with firm performance as the outcome variable.

Data from qualifying firms was obtained in order to conduct the research.

### **4.4 Universe of Analysis (population)**

The chosen population will be South African multinationals listed on the Johannesburg Stock Exchange of South Africa (JSE). The organisation must have at least one operating subsidiary in an emerging market or developed market to qualify as a multinational firm (MNE). In this research, a subsidiary is defined as being where the holding company holds at least 20 per cent in the subsidiary (Lu, Liu, Wright & Filatotchev, 2014).

The current economy is characterised by stagnant growth, increasing retrenchments and record levels of unemployment, which stood at 26.7 per cent according to the latest publication by the Department of Statistics: South Africa (Stats SA, 26 September 2019). It is not an understatement to state that South Africa is facing an economic and employment crisis and understanding the economic consequences of escape FDI has important implications for managers (Cuervo-Cazurra, Ciravegna, Melgarejo & Lopez, 2018). Value creation can have positive outcomes such as increased employment opportunities cascading through to the local community and the economy as a whole. While value destruction can result in increased retrenchments leading to economic hardship. Therefore, the economic consequences of such decisions really do matter.

### **4.5 Sampling Technique (Method and Size)**

The empirical research was focused on South African multinationals who are listed on the Johannesburg Stock Exchange (JSE) and had at least one operating subsidiary in

an emerging market or a developed market in 2018; of which there are 149 companies. To be included in the research, the operating subsidiary must have at least US\$100 million in assets and the holding company must have at least 20 per cent shareholding in that subsidiary. Applying these criteria to the universe, 102 firms were initially identified as the universe.

Each firm was analysed in the study to ensure that the firm met the qualifying criteria. On closer review, 17 firms were removed from the universe because they did not meet the criteria. The majority were excluded because they were either investment holding companies with no operations in other investment locations, or asset managers whose investments consisted of portfolio outflows and not international operating activities.

The final population consisted of 85 firms, of which there are 30 firms operating 100 per cent in emerging markets. The remaining 55 firms have investments in developed markets ranging from one per cent to 84 per cent of group sales or assets.

The entire population was practicable to work with in the given timeframe, and therefore no sampling was required. The empirical research was a longitudinal study going back five years at two interval periods, being 2013 and 2018.

Sales and assets from developed markets were determined according to the classification of developed markets obtained from the World Economic Outlook Report (International Monetary Fund, 2018). The list below identifies the developed markets.

To be designated as a firm with investments in developed markets, the firm must have at least 20 per cent of group sales or group assets derived from a country or countries listed in Table 1. There is no formal accepted threshold percentage sales or assets that can be applied to determine whether a firm qualifies to be classified as developed or developing. In this study it is argued that 20 per cent is an acceptable threshold because when a firm has a 20 per cent shareholding in a subsidiary, it is considered material, in that the firm can influence decision-making. Adopting the same principle; if a South African MNE derives a minimum of 20 per cent of group sales or 20 per cent of its group assets are invested in the developed world, then the related results will be material to the firm's performance. Consequentially, it is be argued that 20 per cent is considered material and sufficient to classify the firm (for the purposes of this study) with investments in developed markets.

**Table 1: Developed countries as classified by the IMF**

Area	Country
Europe	Austria Belgium Cyprus Estonia Finland France Germany Greece Ireland Italy Latvia Lithuania Luxembourg Malta Netherlands Portugal Slovak Republic Slovenia Spain Czech Republic Denmark Iceland Norway Sweden Switzerland San Marino United Kingdom
United States	Canada Puerto Rico
Asia	Hong Kong Korea Macao Singapore Taiwan Japan
Middle East	Israel
Australasia	Australia New Zealand

All other firms will be classified as emerging market firms.

Sales or assets from developed markets as a percentage of total firm sales or assets was used to measure the level of activities of South African multinationals in developed markets as firm subsidiary level data could not be obtained for historical periods (2013).

In both hypotheses, the independent variable was outward foreign direct investment as measured by sales or assets in developed markets as a percentage of total firm sales or assets as a measure of the firm's outward foreign direct investment. The dependent variable was firm performance. To determine whether a statistical correlation existed between the variables, the independent variable was tested against the dependent variable.

## **4.6 Measurement Instrument**

### **4.6.1 Independent Variable(s)**

In this empirical research, outward foreign direct investment, as measured by sales or assets in developed markets as a percentage of total firm sales or assets, is the independent variable.

### **4.6.2 Dependent Variable**

Firm performance will be the dependent variable measured by the change in the following metrics between 2013 and 2018:

- Return on Assets
- Return on Shareholders' Funds
- Tobin's Q
- Market Capitalisation
- Share Price

These are appropriate measures as one of the objectives of the empirical study was to objectively compare the performance of firms participating in an emerging market relative to those participating in developed markets. These metrics will enable this relative comparison and the results for each of these dependent variables will be presented separately.

Return on assets and return on shareholders' funds are accepted measures of firm performance in empirical research and international business (Zhang, Wang, Li, Chen & Wang, 2018).

Tobin's Q is a stock market based measure. This is an appropriate measure as one of the objectives of the empirical study was to determine whether there has been long-term value creation or destruction of market value. Therefore, a market-based measure of profitability has been selected as one of the metrics of performance. The calculation is ratio based on a firm's market-based value to the replacement cost of its assets. Tobin's Q is preferred because it has a strong theoretical and empirical foundation together with overcoming accounting limitations. A high Tobin's Q is representative of the market, which signals that the firm is "worth" more than the book price paid ("Tobin's Q," 1977).

Tobin's Q = (MVE + PS + Debt)/TA where:

- MVE: market value of equity (share price multiplied by number of shares outstanding)
- PS: preference shares is the liquidating value of the firm's preferred share capital
- Debt: value of firm's short-term liabilities net of its short-term assets plus book value of long-term debt
- TA: Total assets is the book value of the firm's total assets at time t.

Comparing share price and market capitalisation will enable this research to achieve the objective of determining whether value was created or destroyed in absolute terms between 2013 and 2018.

#### **4.6.3 Control Variables**

As firm performance is the dependent variable, it was prudent to control for a number of potential influencing variables, being target firms' control variables (Jiangyong et al., 2014).

First, the research controlled for the size of the firm as larger firms perform better than smaller firms, because they have stronger bargaining power and economies of scale. The metric used was absolute market capitalisation in 2018. De Carolis (2003) states that the size of the firm can have a confounding impact on the performance of the firm. This operationalisation is used in the literature (Dhawan, 2001).

Secondly, the research controlled for age of the firms. Firms were grouped into three age bands: 0-30 years, 30-60 years and older than 60 years, such that there are a similar number of firms in each band. This was done for statistical purposes. The



research controlled for age because older firms have had more time to accumulate resources and capabilities than younger firms (Zhang et al. 2018).

## **4.7 Data Gathering Process**

### **4.7.1 Research Instrument**

The initial selection of qualifying firms was obtained from the Orbis database based on 2018 financial data. Orbis was able to identify firms with qualifying subsidiary level data on which the initial selection was made. However, the Orbis database has a limitation in that it does not store historical financial data. Therefore, obtaining corresponding 2013 data from Orbis was not possible. Orbis was used only to select the qualifying firms.

Market-related data (share price and market capitalisation) for 2013 and 2018 was obtained directly from the Johannesburg Stock Exchange (JSE). The Osiris database was subsequently used to obtain the Return on Assets and Return on Shareholders' Funds ratios for both periods. A combination of market-related data and Osiris data (firm assets) was used to calculate Tobin's Q for both periods.

To determine the level of investment in developed markets in this study, all 85 firms' 2018 Integrated Reports of the qualifying South African MNEs were analysed. Sales in developed markets or assets in developed markets was obtained directly from the annual integrated reports and the percentage of the total firm sales or assets was calculated. All data relating to the independent variable is archival data (secondary data).

The data collected is as follows:

- a) Firm name
- b) GICS description: The Global Industry Classification Standard (GICS) was developed by Morgan Stanley Capital International (MSCI) and Standard & Poor's in 1999. The GICS methodology is widely accepted as an industry analysis framework for investment research, portfolio management and asset allocation. The GICS is presented as a 'market-oriented' (rather than a production-oriented) classification system. The GICS structure consists of 10 sectors, 24 industry groups, 67 industries and 147 sub-industries (Osiris Internet Data Guide, 2011).

- c) US SIC codes: The Standard Industrial Classification (SIC) codes have been used since the 1930s and have been revised periodically to reflect changes in the economic structure of the United States. The US SIC was last revised in 1987; however, the overall structure of the SIC has essentially remained unchanged since the first version (Osiris Internet Data Guide, 2011).
- d) Firm age: Firm age was obtained from a combination of Who owns Whom and Internet searches.
- e) Sales or assets by subsidiary was subsequently classified into developed or emerging markets based on the IMF classification listed above. Once classified, the percentage of sales or assets in developed markets was calculated; aggregating up to a firm level.
- f) Dependent variables for 2013 and 2018
- Tobin's Q
  - Return on Assets
  - Market Capitalisation
  - Share Price
  - Return on Shareholders' Funds
- g) Share price and market capitalisation for all firms as at 30 September 2019 was collected from the JSE.

#### **4.7.2 Quality of data: Validity and reliability**

The empirical research data was obtained primarily from three archival (secondary data) sources, being Orbis, Osiris and the JSE for both the independent and dependent variables. The information received from the JSE can be considered accurate and reliable. Where required, supplementary data was obtained directly from the relevant firms published annual integrated reports.

The databases are used on a worldwide basis and the underlying controls relating to the accuracy and validity of the underlying data can be assumed to be present. The databases are used by academic institutions throughout the world and can be considered reliable sources for data extraction. Annual integrated reports are signed off by the firm's auditors and can be considered to be an accurate and reliable source of information.

The data was then transcribed into a workable format to enable the analysis thereof. Before analysis procedures were performed, a completeness check was performed to ensure that all the data that was required was present. Where there were missing market-related data points, the missing information was obtained from Sharenet (financial information service provider, including JSE data). This is considered a reliable source for data extraction.

A quality control procedure was performed on the accuracy and completeness of the data on the final transcribed worksheet; between source data and input data to ensure there were no errors and that the data had been completely and accurately captured.

Formulae where calculations were performed on input data were checked for accuracy. The quality assurance checks on imported data and formulae are considered sufficiently appropriate to conclude that the data used is accurate and reliable for analytical purposes.

During the quality assurance process, missing data points were identified for 22 firms. The missing data points could consist of either missing 2013 data or 2018 data or both for some or all of the variables considered. Of the 22 identified firms, the JSE was able to provide or supplement 19 firms' data, which consisted of share price, number of shares outstanding and related market capitalisation. The source of data is considered reliable and trustworthy.

#### **4.8 Data Analysis**

This research intended to explore the relationship between the independent variable (outbound foreign direct investment) and multiple dependent variables (performance). According to Matear, Osborne, Garrett and Gray (2002), the unidimensionality of all constructs is assessed using confirmatory factor analysis.

The initial statistics that were calculated were the descriptive statistics of the population. The results showed the number of firms that created or destroyed value between 2013 and 2018. The results relate to firms predominantly investing in emerging markets with up to 20 per cent investment in developed markets, compared to those investing in both emerging and developed markets (over 20 per cent investment), in order for the population to be better understood. This was calculated for each of the metrics associated with performance of the data. No further tests were performed on the descriptive observations.

Descriptive statistics were also calculated on the relative performance of firms between 2013 and 2018 to determine the absolute value created or destroyed, and categorised between emerging and developed market firms. This analysis was repeated for the period 2013 to 2019 to determine whether material changes in relative performance between 2018 and 2019 had occurred.

Subsequent to the initial descriptive statistics, the number of firms creating or destroying value by industry are also shown. This is also categorised by firms investing in emerging markets with a degree of investment in developed markets of up to 20 per cent, compared to firms investing in emerging and developed markets with investment over 20 per cent. In this analysis, only share price and market capitalisation independent variables were used.

The next step was to graphically represent the data points for each of the independent variables and the spread of the data. This was done through box and whisker plots, which are useful for indicating whether the distribution of data is skewed as well as for identifying outliers (Marmolejo-Ramos, F., Tian, S. 2010). The box plot summarises, graphically, the following five data points:

- (1) Lower extreme observation;
- (2) Lower quartile (indicated by the bottom of the box), which is defined as the observation such that 75 per cent of all observations will be higher than this observation;
- (3) Median is indicated by the dark line inside the box (middle value in the dataset);
- (4) Upper quartile (indicated by the top of the box), which is defined as the observation such that 25 per cent of all observations will be higher than this observation; and
- (5) Upper extreme observation.

Where the difference between the first and third quartiles is defined as the interquartile range, outliers are indicated in the smaller circles and are defined as observations more than 1.5 times the interquartile range away from either the first or the third quartile.

Where the box is narrow or the whiskers are short, it is indicative of observations being clustered around some value. Where the median value is not in the centre of the box, it is indicative of a skewed distribution of observations.

The subsequent steps fitted a regression model to the population in order to determine whether value was created or destroyed when firms invested in developed markets. This did not consider how much value was created or destroyed, but simply considered the binary observations of value creation or destruction.

For the statistical analysis, the model fitted a linear regression model to the data points. The application used is R. R is a free software environment for statistical computing and graphics. The following libraries were used in the analyses that follow:

- *olsrr*: Tools designed to make it easier for users to build ordinary least squares regression models. This includes comprehensive regression output, heteroskedasticity tests, collinearity diagnostics, residual diagnostics, measures of influence, model fit assessment and variable selection procedures.
- *aod*: Provides a set of functions to analyse over dispersed counts or proportions. Most of the methods are already available elsewhere but are scattered in different packages. The proposed functions should be considered as complements to more sophisticated methods such as generalised estimating equations or generalised linear mixed effect models.

Linear regression is a common statistical data analysis technique. It can be used to show or predict the extent to which there is a linear relationship between a dependent variable and one or more independent variables.

The research used regression analysis to describe the relationships between the set of independent variables and the dependent variable. This produced a regression equation where the coefficients represented the relationship between each independent variable and the dependent variable. While this model can be used to make predictions, the purpose of the research was explanatory in nature, rather than predictive.

For the first part of the analysis, the study relied on a logit model (logistic regression). This model required that the dependent variable be binary rather than a continuous observation. This was applicable as in this test, the dependent variable is binary and discrete: value creation or value destruction.

To execute the above, the data needed to be valid prior to conducting multiple regression. This translated mainly into dealing with outliers appropriately. Outliers were identified from the distribution or scatterplot and excluded from the regression model. If the difference was not statistically material, then they did not pose an issue for the analysis and were not be removed. According to Tabachnick and Fidell (2013), outliers have a standardised residual below -3.3 and greater than 3.3.

Influential points from an initial run of the model were identified as outliers using DFFITS statistics. The model was then run without the outliers in the data. DFFITS is a diagnostic tool meant to show how influential a point is in a statistical regression. It is defined as the Studentized DFFIT, where the latter is the change in the predicted value for a point, obtained when that point is left out of the regression (Belsley, Kuh, Welch & Roy, 1980).

In order to find an appropriate regression model, the fit of the model was considered. This was done to ensure that the fitted variables were found to be statistically significant. This was done to confirm both hypotheses and to determine the strength of the linear correlation between the dependent variable and each independent variable. The confidence level adopted in this research was a 90 per cent level of significance, which is acceptable.

The model was selected using a backwards stepwise process that found the minimum Akaike information criterion (AIC). In estimating the amount of information lost by a model, AIC deals with the trade-off between the goodness of fit of the model and the simplicity of the model. In other words, AIC deals with both the risk of overfitting and the risk of underfitting (Burnham, Anderson, & Huyvaert, 2010).

#### **4.9 Limitations in the Method and Data**

The study used a longitudinal approach which had its limitations. The study used a five-year time horizon being 2013 to 2018. It would have been valuable to study the same qualifying firms over a longer time horizon and through the economic cycle, when performance is influenced by both recessionary as well as boom economic conditions. The study was performed against the backdrop of a global economy characterised by growth. If the study had included a recessionary period, it would have added richness of insight into firm performance because of different economic conditions and the related impact on firm performance. Due to time constraints and data limitations it was not feasible to adopt an expanded longitudinal approach.

The study used the firm as the unit of analysis when it was preferable to use the subsidiary as the unit of analysis. This would have enabled the study to obtain a greater understanding of economic performance of escape FDI as subsidiaries within a firm would have allowed a comparison between subsidiary performance, especially if a firm had subsidiaries in both emerging markets and developed markets. The study did not contain this data due to time constraints and lack of availability of subsidiary level data in major databases. The research had to use percentage sales/asset as a proxy for investment in developed markets. The consequences of this was that a firm with 20 per cent of sales/assets derived from a developed market is classified as a firm that invested in both a developed and emerging market.

This might have led the study to attribute economic performance to activities derived from the developed market, when in fact the economic performance may have been derived from activities in the emerging market. To overcome that limitation, the study included an investigation into firms with material value creation or destruction to determine the origin of that firm level value creation or destruction. That formed part of the insights into the results of the statistical analysis conducted in Chapter 5. This was reported on in the discussion on the results, Chapter 6.

Other limitations related to the dependent variables themselves. Market capitalisation may be influenced, positively or negatively, by financial engineering. This includes raising capital through issuing shares and artificially increasing share price by instituting share buy-back schemes. Therefore, in certain circumstances, increases or decreases in market capitalisation may not be related to operating performance in the normal course of business, but to financial engineering.

Share price may be influenced by financial engineering, such as share splits. Therefore, in this circumstance, it would appear that there has been value destruction, where in fact, there has been no firm value destruction.

Return on assets may be significantly influenced by intangible assets, thereby diminishing the appropriateness of the ratio, which may further be diminished due to debt not being included in the ratio.

The research was quantitative in nature, and inherently revolved around the investment motive to undertake operational activities in another international location. Escape FDI was the independent variable and firms may be investing in developed markets for reasons other than escape FDI. This could include market seeking or strategic asset

seeking motives. Therefore, gaining a deeper understanding related to choice of location may not be possible.

The research was conducted in the local currency, being rands and not dollars. This is because the study used the South African MNE firm as the unit of analysis and the reporting currency is rands. The last significant limitation that requires identification and discussion was the impact of the exchange rate over the 2013 to 2018 period. The rand lost 38.9 per cent of its value against the dollar between 2013 and 2018, deteriorating from R9.881570/\$1 to R13.724039/\$1. The impact of the deterioration of the rand over the period was material and had a profound effect on overall firm performance. This noted limitation was material to the study.

#### **4.10 Conclusion**

The research methodology that was used was deemed appropriate to substantiate the two main hypotheses. The philosophy of the study was positivism and was deductive in approach, being a quantitative analysis. Secondary archival data was collected and used to statistically prove the hypotheses gleaned from the literature. The nature of the study was longitudinal. The population was South African multinationals with at least one operating subsidiary in a foreign location, partaking in operational activities, with a minimum shareholding of 20 per cent. The unit of analysis was the South African firm. 102 firms were identified initially that qualified. Upon further analysis, this was reduced to a final population of 85 South African multinationals. Missing data was obtained from the Johannesburg Stock Exchange, Sharenet and relevant annual integrated reports. The application used to perform the data analysis was R. Descriptive and linear regression statistics were performed on the dataset and were descriptive and confirmatory in nature. Identified outliers were removed. Chapter five will state the results of the tests that were performed.



## **Chapter 5: RESULTS**

### **5.1 Introduction**

This chapter examines the minutiae of the findings of the data that was obtained from the Johannesburg Stock Exchange, complemented by data obtained from the Osiris database and the firms' 2018 annual integrated reports to enable appropriate analysis by the unit of analysis.

It is foreseen that the tests that were performed will prove the confirmatory test as well as the two hypotheses. Furthermore, it is expected that in addition to descriptive analytics, linear regression analysis will prove that explanatory relationships existed between escape FDI and firm performance. This chapter will continue on the basis that the data related to the 85 firms was complete, accurate, valid and sufficiently robust to achieve an acceptable level of analysis for the purposes of the tests that were performed on it, both descriptive and statistical in nature.

This chapter is structured in such a way that all the tests are clustered around Hypothesis 1 and Hypothesis 2. Each section begins with descriptive statistics, followed by the regression analysis.

### **5.2 Description of Sample Obtained**

#### **5.2.1 Population**

The sample included South African multinationals that are listed on the JSE with at least one subsidiary in an emerging market or a developed market. To be included in the sample, the operating subsidiary must have at least US\$100 million in assets and the holding company must have at least a 20 per cent shareholding of which there were originally 102 qualifying firms. Therefore, an EMNE for the purposes of this study can be defined as an international company originating from South Africa, where the holding company exercises effective control over the subsidiary and the subsidiary undertakes value-adding activities in one or more foreign locations (Luo & Tung, 2007)

Upon further analysis, 17 firms were removed because they did not meet the definition of an EMNE. Anchor Group Limited and Coronation Fund Managers Limited were removed because they are asset managers and their investments are comprised of portfolio investments. Steinhoff Investment Holdings Limited was removed because

information was not available, and its value destruction can be predominantly attributed to fraud. Long4Life Limited, Motus Holdings Limited and JCI Limited were removed because the relevant data points could not be obtained. Capitec Bank Limited has operations in South Africa only. Ellerine Holdings Limited, Fortress Reit Limited, Hosken Consolidated Limited, RMB Investment Holdings Limited, PSG Group Limited, Remgro Limited and RMB Holdings Limited are all investment holding companies with no operating subsidiaries. Investec Bank Limited is a subsidiary of Investec Limited; Illovo Sugar was de-listed on 27 June 2016 and Massmart Holdings is a subsidiary of Walmart, a US-based DMNE. The final population was 85 firms.

The final population contains 85 qualifying South African MNEs, of which there were 30 firms operating 100 per cent in emerging markets. The remaining 55 firms have a combination of activities in both emerging and developed markets, and based on sales or assets, the percentage of sales or assets derived from, or invested in, developed markets ranged from one per cent to 84 per cent.

### ***5.2.2 Results on reliability and validity of data***

The market-related information was obtained from the JSE, being share price and corresponding market capitalisation data. The source was considered reliable and accurate. The data relating to the ratios such as Return on Assets and Return on Shareholders' Returns was extracted from the Osiris database and checked for completeness and was considered to be reliable and valid. Missing data points were obtained from Sharenet, a reputable financial information services organisation. Tobin's Q was calculated from information from Osiris and the JSE. In the study, the complete set of annual integrated reports for 2018 for all 85 firms were reviewed to determine the percentage invested in developed markets. The source documentation was considered reliable. The study included quality assurance checks, which were performed by an independent party to ensure data capturing was complete and accurate. This also included checking formulae for calculations and re-performing calculations to ensure their accuracy. Overall, the data was considered reliable, complete and accurate.

### ***5.2.3 Data Transformations***

The share price and the market capitalisation data was obtained for 2013 and 2018. In addition, the share prices were obtained for the period ending 30 September 2019. The market capitalisation at that date was recalculated based on calculating the number of outstanding shares from 2018 (market capitalisation divided by share price).

This was done to arrive at a market capitalisation that would exclude financial transactions, such as share issues for 2019. This procedure was performed to ascertain whether there were material movements in market capitalisation for any firms in the intervening period (2018 to 2019).

#### **5.2.4 Firms investing in emerging and developed markets**

**Table 2: Number of firms and percentage sales invested in developed markets**

<b>Number of firms</b>	<b>0% investment</b>	<b>0%-10% investment</b>	<b>10% - 20% investment</b>	<b>20% - 30% investment</b>	<b>&gt;30% investment</b>
Actual	30	13	8	14	20
	35.3%	15.3%	9.4%	16.5%	23.5%
Aggregate	30	43	51	65	85
	35.3%	50.6%	60.0%	76.5%	100.0%

Table 2 delineated the number of firms investing in emerging and developed markets. Thirty firms invested 100 per cent in emerging markets, with thirteen firms deriving up to 90 per cent of their sales or assets invested in emerging markets and a further eight firms deriving 80 per cent of their sales or assets invested in emerging markets. Therefore, fifty-one (60 per cent) firms were classified as South African firms operating in emerging markets. Thirty-four firms (40 per cent) derived over 20 per cent of their sales from developed markets or have over 20% productive assets invested in developed markets.

To summarise, there were 51 firms (60 per cent) that were classified as South African firms operating in emerging markets and 34 firms (40 per cent) that are classified as South African firms operating in developed market for the statistical analysis that was conducted and detailed in the following sections.

## 5.3 Hypothesis 1: Descriptive Results at a Consolidated Level

**Table 3: Descriptive results for each dependent variable**

Dependent variable	Number of firms classified as emerging market firms		Number of firms classified as developed market firms		Total
	Created value	Destroyed value	Created value	Destroyed value	
Tobin's Q	21	30	13	21	85
ROA	20	31	13	21	85
Market cap	28	23	18	16	85
Share price	28	23	15	19	85
ROSF	21	30	13	21	85

The data reveals that hypothesis 1 (hypothesis 1a and hypothesis 1b) is not supported. It appears that on average, 40 per cent of firms that invested abroad in developed markets destroyed value, which is insufficiently significant. This is evidenced by an absolute negative change in share price between 2013 and 2018 measured on the total population. Tobin's Q, Return on Assets (ROA) and Return on Shareholders' Funds (ROSF) are all negative, indicating value destruction.

### 5.3.1 Descriptive results by share price

**Table 4: Creation or destruction of value by share price**

Industry	Number of firms classified as emerging market firms		Number of firms classified as developed market firms		Total
	Created value	Destroyed value	Created value	Destroyed value	
Clothing retail	1	0	1	1	3
Construction	0	1	0	3	4
Diversified retail	2	0	1	1	4
Financial services	7	3	4	0	14
Fishing	0	0	0	1	1
Food retail	0	0	1	0	1
Gaming	0	1	0	0	1
Healthcare	1	0	0	2	3

Industry	Number of firms classified as emerging market firms		Number of firms classified as developed market firms		Total
	Created value	Destroyed value	Created value	Destroyed value	
ICT	2	3	0	1	6
Industrial	3	5	2	6	16
Industrial foods	3	0	0	1	4
Manufacturing	1	2	3	0	6
Media	2	0	0	0	2
Mining	2	5	0	3	10
Pharmaceuticals	0	1	1	0	2
Property	4	2	2	0	8
Grand Total	28	23	15	19	85

The data reveals that hypothesis 1 (hypothesis 1a and hypothesis 1b) is not supported. It appears that firms that invested abroad in developing markets and developed markets created and destroyed value fairly evenly. This is based on an absolute change in share price between 2013 and 2018.

### 5.3.2 Descriptive results by market capitalisation

**Table 5: Creation or destruction of value by market capitalisation**

Industry	Number of firms classified as emerging market firms		Number of firms classified as developed market firms		Total
	Created value	Destroyed value	Created value	Destroyed value	
Clothing retail	1	0	1	1	3
Construction	0	1	0	3	4
Diversified retail	2	0	2	0	4
Financial services	7	3	4	0	14
Fishing	0	0	1	0	1
Food retail	0	0	1	0	1
Gaming	0	1	0	0	1
Healthcare	1	0	0	2	3

Industry	Number of firms classified as emerging market firms		Number of firms classified as developed market firms		Total
	Created value	Destroyed value	Created value	Destroyed value	
ICT	1	4	0	1	6
Industrial	3	5	2	6	16
Industrial foods	3	0	1	0	4
Manufacturing	1	2	3	0	6
Media	1	1	0	0	2
Mining	2	5	0	3	10
Pharmaceuticals	0	1	1	0	2
Property	6	0	2	0	8
Grand Total	28	23	18	16	85

The data reveals that hypothesis 1 (hypothesis 1a and hypothesis 1b) is not supported. It appears that firms that invested abroad in developing and developed markets created and destroyed value evenly. This is based on an absolute change in market capitalisation between 2013 and 2018.

Hypothesis 1a postulated that escape FDI by South African firms to emerging markets is positively correlated to performance (value creation). Based on market capitalisation to measure absolute value creation or destruction between 2013 and 2018, the data does not support this hypothesis. Of the 51 emerging market firms, 28 (55 per cent) created value and 23 (45 per cent) destroyed value. Firms that created or destroyed value are evenly distributed.

Hypothesis 1b postulated that escape FDI by South African firms to developed markets is negatively correlated to performance (value destruction). Of the 34 developed market firms, 18 (53 per cent) created value and 16 (47 per cent) destroyed value. Firms that created or destroyed value are evenly distributed.

### ***5.3.3 Statistical results of individual firm value creation or destruction by South African MNEs invested in either emerging markets or developed markets***

Hypothesis 1 is binary and was only concerned with individual firm performance. At firm level, did the firm create or destroy value. It did not consider the quantum of value creation or destruction. That is dealt with in hypothesis 2.

Hypothesis 1a was concerned with escape based FDI by South African firms to emerging markets which it hypothesised to be positively correlated to performance (value creation). Hypothesis 1b was concerned with escape based FDI by South African firms to developed markets which it hypothesized to be negatively correlated to performance (value destruction).

When the study tested hypothesis 1, the study used the following dependent variables:

- Tobin's Q
- Return on Assets
- Market Capitalisation
- Share Price
- Return on Shareholders' Funds

*Tobin's Q:*

Destroyed Tobin's Q ~ Percentage of sales in developed market + Age of firm + log (2018 market capitalisation of firm + 1)

**Table 6: Hypothesis 1: Tobin's Q linear regression model fit**

Variable	Estimate	Standard error	z value	Pr(> z )	Statistical significance
Intercept	22.2779	15.6858	1.42	0.156	None
Percentage of investment in developed markets	-0.822	0.9651	-0.852	0.394	None
Age group 30 to 60	0.3652	1.4501	0.252	0.801	None
Age group 60 +	0.3602	1.105	0.326	0.744	None
log(market cap + 1)	-0.9179	0.6365	-1.442	0.149	None

The data shows that percentage investment in developed markets not to have a statistically significant impact on the likelihood of destroying value when measuring destruction in Tobin's Q.

None of the variables in this model are found to be statistically significant.

*Return on assets:*

Destroyed ROA ~ Percentage of sales in developed market + Age of firm + log (2018 market capitalisation of firm + 1)

**Table 7: Hypothesis 1: Return on assets linear regression model fit**

Variable	Estimate	Standard error	z value	Pr(> z )	Statistical significance
Intercept	4.52843	2.96121	1.529	0.126	None
Percentage of investment in developed markets	-0.32382	0.47038	-0.688	0.491	None
Age group 30 to 60	-0.07663	0.5832	-0.131	0.895	None
Age group 60 +	-0.31641	0.56311	-0.562	0.574	None
log(market cap + 1)	-0.16852	0.1241	-1.358	0.174	None

The data shows that percentage investment in developed markets not to have a statistically significant impact on the likelihood of destroying value when measuring destruction in return on assets.

None of the variables in this model are found to be statistically significant.

*Market capitalisation:*

Destroyed market cap ~ Percentage of sales in developed market + Age of firm + log (2018 market capitalisation of firm + 1)

**Table 8: Hypothesis 1: Market capitalisation linear regression model fit**

Variable	Estimate	Standard error	z value	Pr(> z )	Statistical significance
Intercept	15.1842	4.2527	3.57	0.000356	on a 0.1% level of significance
Percentage of investments in developed markets	-0.1276	0.5075	-0.251	0.801512	None
Age group 30 to 60	0.6274	0.6343	0.989	0.322591	None
Age group 60 +	0.6485	0.6105	1.062	0.288147	None
log(market cap + 1)	-0.666	0.1812	-3.675	0.000237	on a 0.1% level of significance

The data shows that percentage investment in developed markets not to have a statistically significant impact on the likelihood of destroying value when measuring destruction in market capitalisation.



Size of the organisation is shown to have a statistically significant impact on the firm's likelihood of failing. The larger the firm is in terms of market capitalisation (2018), the more likely the firm is to create value.

*Share price:*

Destroyed share price ~ Percentage of sales in developed market + Age of firm + log (2018 market capitalisation of firm + 1)

**Table 9: Hypothesis 1: Share price linear regression model fit**

Variable	Estimate	Standard error	z value	Pr(> z )	Statistical significance
Intercept	10.753	3.5344	3.042	0.00235	on a 1% level of significance
Percentage of investment in developed markets	-0.5669	0.4814	-1.178	0.23893	None
Age group 30 to 60	-0.3254	0.593	-0.549	0.58316	None
Age group 60 +	0.2637	0.5735	0.46	0.6456	None
log(market cap + 1)	-0.4429	0.1476	-3	0.0027	on a 1% level of significance

The data shows that percentage investment in developed markets not to have a statistically significant impact on the likelihood of destroying value when measuring destruction in share price.

Size of the organisation is shown to have a statistically significant impact on the firm's likelihood of failing. Smaller firms are more likely to destroy value. Indirectly, the larger the firm was in terms of market capitalisation in 2018, the more likely it was to create value.

*Return on shareholders' funds:*

Destroyed ROSF ~ Percentage of sales in developed market + Age of firm + log (2018 market capitalisation of firm + 1)

**Table 10: Hypothesis 1: Return on shareholders' funds linear regression model fit**

Variable	Estimate	Standard error	z value	Pr(> z )	Statistical significance
Intercept	3.342	2.99351	1.116	0.264	None
Percentage of investment in developed markets	-0.04266	0.46737	-0.091	0.927	None
Age group 30 to 60	0.51949	0.57939	0.897	0.37	None
Age group 60 +	0.39625	0.5551	0.714	0.475	None
log(market cap + 1)	-0.13707	0.12593	-1.088	0.276	None

The data shows that percentage investment in developed markets not to have a statistically significant impact on the likelihood of destroying value when measuring destruction in return on shareholders' funds.

None of the variables in this model are found to be statistically significant.

Hypothesis 1 is not supported as the results show that none of the dependent variables are statistically significant.

#### 5.4 Hypothesis 2: Descriptive Results at a Consolidated Level

**Table 11: Change in market capitalisation between 2013 and 2018 by industry**

Industry	Developed	Emerging	Grand Total
Clothing retail	12 573 315 989	23 512 216 764	36 085 532 753
Construction	-15 496 422 546	-3 928 760 918	-19 425 183 464
Diversified retail	18 834 097 974	42 105 670 243	60 939 768 216
Financial services	63 331 293 922	453 311 120 638	516 642 414 561
Fishing	648 947 147	0	648 947 147
Food retail	1 932 176 261	0	1 932 176 261
Gaming	0	-2 559 022 602	-2 559 022 602
Healthcare	-76 483 910 427	6 784 033 313	-69 699 877 114
ICT	-5 671 335 799	-89 124 547 525	-94 795 883 324
Industrial	17 426 867 849	-2 198 167 191	15 228 700 658
Industrial foods	92 278 222 310	19 867 521 597	112 145 743 907

Industry	Developed	Emerging	Grand Total
Manufacturing	67 138 587 692	-13 050 823 987	54 087 763 705
Media	0	1 225 283 550 350	1 225 283 550 350
Mining	-14 608 956 997	-83 730 978 513	-98 339 935 510
Pharmaceuticals	14 380 311 007	-97 893 992	14 282 417 015
Property	37 724 214 379	78 564 424 192	116 288 638 571
<b>Grand Total</b>	<b>214 007 408 760</b>	<b>1 654 738 342 370</b>	<b>1 868 745 751 130</b>
<b>Per cent</b>	<b>11%</b>	<b>89%</b>	<b>100%</b>
Naspers		1 225 371 976 545	1 225 371 976 545
<b>Total excluding Naspers</b>	<b>214 007 408 760</b>	<b>429 366 365 825</b>	<b>643 373 774 585</b>
<b>Per cent</b>	<b>33%</b>	<b>67%</b>	<b>100%</b>

In Table 11, market capitalisation increased for both developed and developing markets by R1,9 trillion, of which R1,2 trillion is attributable to Naspers (which is considered an outlier). Adjusting for Naspers, emerging markets created twice the value than that of developed market firms. This confirms hypothesis two, whereby firms that invested in emerging markets created more value than firms that invested in developed markets. This can be stated because the significant driver of value creation of Naspers is attributable to its investment in Tencent, a Chinese emerging market firm.

**Table 12: Change in market capitalisation between 2013 and 2019 by industry**

Industry	Developed	Emerging	Grand Total
Clothing retail	-654 900 716	6 047 539 371	5 392 638 655
Construction	-18 462 960 480	-4 079 187 017	-22 542 147 497
Diversified retail	19 522 869 059	-23 271 745 690	-3 748 876 632
Financial services	35 165 617 460	364 697 826 338	399 863 443 798
Fishing	-646 682 886	0	-646 682 886
Food retail	-1 248 105 947	0	-1 248 105 947
Gaming	0	-4 637 333 255	-4 637 333 255
Healthcare	-104 586 684 733	-8 029 035 162	-112 615 719 895
ICT	-2 714 512 599	-119 970 928 321	-122 685 440 920
Industrial	-164 652 947 479	-19 582 127 433	-184 235 074 912

Industry	Developed	Emerging	Grand Total
Industrial foods	107 955 015 179	-5 007 364 712	102 947 650 468
Manufacturing	26 678 601 997	-17 064 572 490	9 614 029 508
Media	0	703 249 258 031	703 249 258 031
Mining	57 965 796 651	188 136 625 964	246 102 422 614
Pharmaceuticals	-64 252 595 961	-3 352 869 219	-67 605 465 180
Property	26 680 297 894	51 181 243 149	77 861 541 043
<b>Grand Total</b>	<b>-83 251 192 560</b>	<b>1 108 317 329 554</b>	<b>1 025 066 136 994</b>
<b>Per cent</b>	<b>-8%</b>	<b>108%</b>	<b>100%</b>
Naspers		703 393 199 138	703 393 199 138
<b>Total excluding Naspers</b>	<b>-83 251 192 560</b>	<b>404 924 130 416</b>	<b>321 672 937 856</b>
<b>Per cent</b>	<b>-32%</b>	<b>132%</b>	<b>100%</b>

In Table 12, emerging markets created R1,1 trillion value by market capitalisation. Of this, R703 billion related to Naspers. Adjusting for Naspers, emerging markets created R405bn, whereas developed markets destroyed –R83 billion in market capitalisation.

This appears to support hypothesis 2, whereby firms that invested in emerging markets created more value than firms that invested in developed markets. This can be stated before and after adjusting for Naspers, the significant driver of value creation of Naspers is attributable to its investment in Tencent, a Chinese emerging market firm.

Between the original longitudinal study ending in 2018 and market capitalisation as at 30 September 2019, -R844 billion in market capitalisation was destroyed. Of this, 80 per cent is attributable to two firms, being Naspers (-R522 billion) and Sasol (-R156 billion).

#### **5.4.1 Statistical results comparing total value creation or destruction by South African firms that invested in either emerging markets or developed markets**

Hypothesis 2 was concerned with whether South African firms that invested in other emerging markets created more value than South African firms that invested in developed markets.

When the study tested hypothesis 2, the study used the following dependent variables:

- Tobin's Q
- Return on Assets
- Market Capitalisation
- Share Price
- Return on Shareholders' Funds

*Tobin's Q:*

Change in Tobin's Q ~ Sales in developed markets + Age of firm + log (2018 market capitalisation of firm)

**Table 13: Linear regression on change in Tobin's Q**

Variable	Estimate	Standard error	t value	Pr(> t )	Statistical significance
Intercept	-11.5029	5.2325	-2.198	0.044	on a 5% level of significance
Age group 30 to 60	-0.5314	0.8532	-0.623	0.5427	None
Age group 60 +	-0.7189	0.6067	-1.185	0.2545	None
Developed market investment up to 20%	1.1076	0.5152	2.15	0.0483	on a 5% level of significance
log(market cap)	0.4349	0.2129	2.043	0.059	on a 10% level of significance

Multiple R-squared: 0.4029

From this, 40.32 per cent of the variation is explained by the variables considered in the model.

F-statistic: 2.53 on four and 15 DF, p-value: 0.08409

This suggests the fitted model is better than a null model. The model therefore explains returns in a statistically significant way.

Market capitalisation was shown to be statistically significant. Firms with a larger market capitalisation are shown to have performed better than firms with a relatively smaller market capitalisation in 2018.

Fundamentally, the data shows that firms that invested in developed markets performed relatively worse than firms that invested in emerging markets. This was

considered statistically significant on a five per cent level of significance. This confirms hypothesis 2.

*Return on assets:*

Change in return on assets ~ Sales in developed markets + Age of firm + log (2018 market capitalisation of firm)

**Table 14: Linear regression on change in return on assets**

Variable	Estimate	Standard error	t value	Pr(> t )	Statistical significance
Intercept	-32.1291	15.7086	-2.045	0.0445	on a 5% level of significance
Age group 30 to 60	0.745	3.1395	0.237	0.8131	None
Age group 60 +	4.2064	3.0631	1.373	0.1739	None
Developed market sales more than 0%	-0.6134	2.5509	-0.24	0.8107	None
log(market cap)	1.1511	0.665	1.731	0.0878	on a 10% level of significance

Multiple R-squared: 0.07359

From this, 7.39 per cent of the variation is explained by the variables considered in the model.

F-statistic: 1.43 on four and 72 DF, p-value: 0.2328

Starting AIC: 372.11

This suggests the fitted model is better than a null model. The model therefore explains returns in a statistically significant way.

Market capitalisation in 2018 was the only variable shown to be statistically significant. It shows that firms with larger market capitalisations in 2018 have relatively higher increases on return on assets over the five-year period.

*Market capitalisation:*

Percentage change in Market Cap ~ Sales in developed markets + Age of firm + log (2018 market capitalisation of firm).

**Table 15: Linear regression analysis on change in market capitalisation including all observations**

Variable	Estimate	Standard error	t value	Pr(> t )	Statistical significance
Intercept	-67.035	265.84	-0.252	0.8016	None
Age group 30 to 60	-93.827	52.819	-1.776	0.0795	on a 10% level of significance
Age group 60 +	-102.994	51.867	-1.986	0.0505	on a 10% level of significance
Developed market investment up to 20%	-34.977	43.44	-0.805	0.4231	None
log(market cap)	7.847	11.173	0.702	0.4845	None

Multiple R-squared: 0.06393,

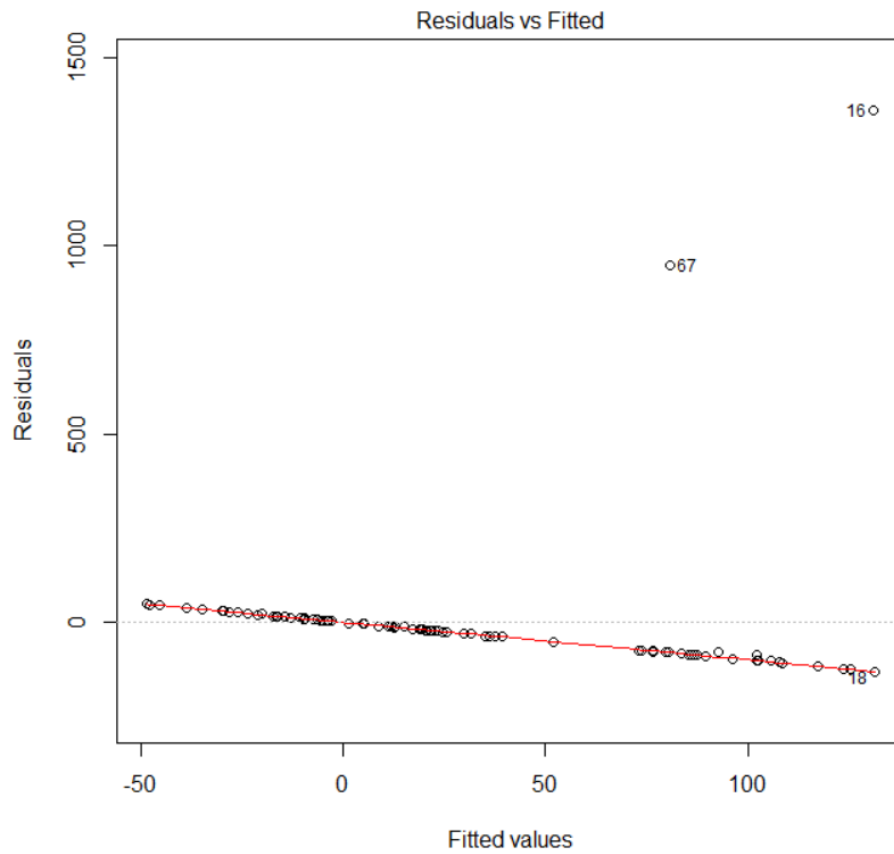
From this, 6.39 per cent of the variation is explained by the variables considered in the model.

F-statistic: 2.604 on four and 91 DF, p-value: 0.04094

This suggests the fitted model is better than a null model. The model therefore explains returns in a statistically significant way.

This model had a start AIC of 900.1. In this model, the AIC increased for any variable removed from the model. The suggestion is therefore to keep all variables in the model.

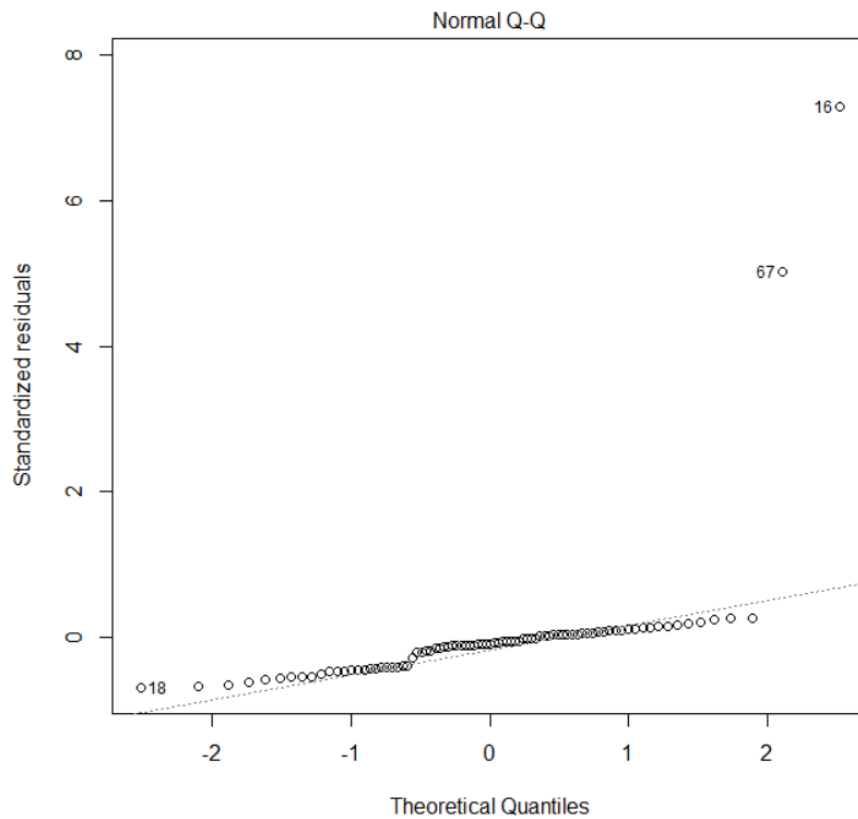
Age of the firm is shown to have a statistically significant impact on the firm's likelihood of failing. Firms older than 30 years are shown to have performed worse and are more likely to destroy value than firms younger than 30 years. From this it was deduced that younger firms created more value than firms older than 30 years.



**Figure 1: Residuals versus fitted model**

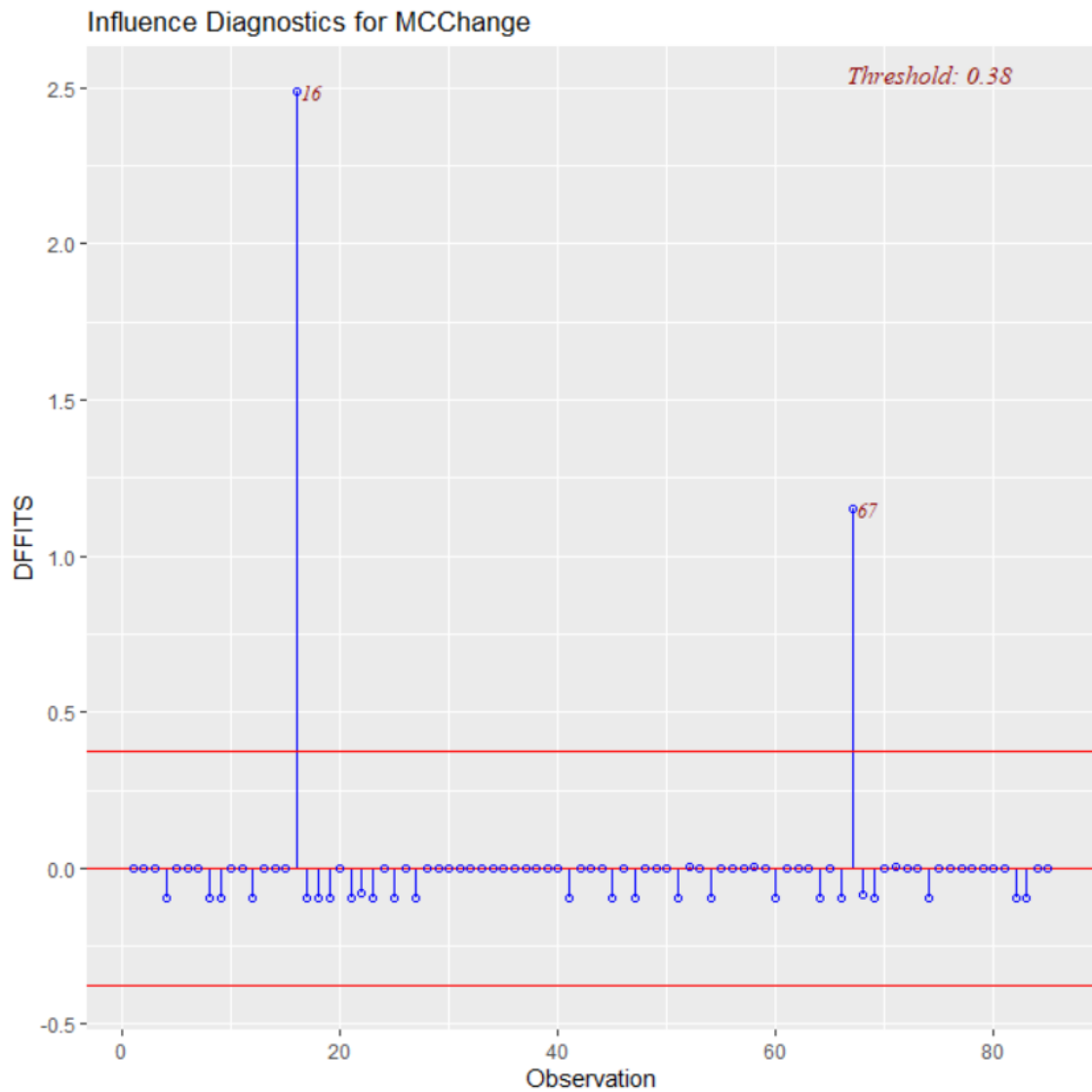
Observations 16 and 67 are Bid Corporation Limited and PSG Konsult Limited respectively. These observations are shown to differ significantly from the model expectation.





**Figure 2: Normal Q-Q plot**

The Q-Q Plot (or Quantile-Quantile Plot) is a graphical tool to assess if the dataset comes from a normal distribution. It is a visual check and allows the user to see if the data fits the normal distribution and, if negative, how the assumption is violated and which data points contribute to the violation. The data points are shown to be a good fit in the model. Observations 16 (Bid Corporation Limited) and 67 (PSG Konsult Ltd) are shown to not fit the model.



**Figure 3: DFFITS plot of observations**

Outliers were identified using DFFITS. The following were excluded from the model:

- Bid Corporation Limited (16)
- PSG Konsult Limited (67)

After removing the outliers, the following regression model was derived.

Percentage change in Market Cap ~ Sales in developed markets + Age of firm + log(2018 market capitalisation of firm)

**Table 16: Linear regression model on change in market capitalisation excluding outliers**

Variable	Estimate	Standard error	t value	Pr(> t )	Statistical significance
Intercept	-1.3227	3.2661	-0.405	0.6866	None
Age group 30 to 60	-1.4003	0.6597	-2.123	0.037	on a 5% level of significance
Age group 60 +	-1.4063	0.6505	-2.162	0.0337	on a 5% level of significance
Developed market investment up to 20%	-0.4091	0.5405	-0.757	0.4514	None
log(market cap)	0.1338	0.1377	0.972	0.3342	None

Multiple R-squared: 0.08291

From this, 8.35 per cent of the variation is explained by the variables considered in the model.

F-statistic: 1.763 on four and 78 DF, p-value: 0.1448

This suggests the fitted model is better than a null model. The model therefore explains returns in a statistically significant way.

This model had a start AIC of 148.28. In this model, the AIC increased for any variable removed from the model. The suggestion is therefore to keep all variables in the model.

Age was shown to be statistically significant. Firms older than 30 years are shown to have performed worse relative to firms younger than 30 years.

*Share price:*

Percentage change in share price ~ Sales in developed markets + Age of firm + log (2018 market capitalisation of firm)

**Table 17: Linear regression on change in share price**

Variable	Estimate	Standard error	t value	Pr(> t )	Statistical significance
Intercept	-3.70568	0.95918	-3.863	0.00023	on a 0.1% level of significance
Age group 30 to 60	0.10033	0.19219	0.522	0.60314	None
Age group 60 +	0.13201	0.18891	0.699	0.48677	None

Variable	Estimate	Standard error	t value	Pr(> t )	Statistical significance
Developed market investment up to 20%	0.01747	0.15682	0.111	0.9116	None
log(market cap)	0.15894	0.04006	3.968	0.00016	on a 0.1% level of significance

Multiple R-squared: 0.1737

From this, 17.43 per cent of the variation is explained by the variables considered in the model.

F-statistic: 4.098 on four and 78 DF, p-value: 0.004567

This suggests the fitted model is better than a null model. The model therefore explains returns in a statistically significant way.

Market capitalisation was shown to be statistically significant. Firms with a larger market capitalisation are shown to have performed better than firms with a relatively smaller market capitalisation in 2018.

*Return on shareholders' funds:*

Change in return on shareholders' funds ~ Sales in developed markets + Age of firm + log (2018 market capitalisation of firm)

**Table 18: Linear regression on change in return on shareholder's funds**

Variable	Estimate	Standard error	t value	Pr(> t )	Statistical significance
Intercept	-3.7589	39.4034	-0.095	0.924	None
Age group 30 to 60	3.9784	7.4598	0.533	0.595	None
Age group 60 +	7.705	7.0762	1.089	0.28	None
Developed market sales more than 0%	-6.5961	5.9725	-1.104	0.273	None
log(market cap)	-0.1232	1.6643	-0.074	0.941	None

Multiple R-squared: 0.03781

From this, 3.78 per cent of the variation is explained by the variables considered in the model.

F-statistic: 0.7073 on four and 72 DF, p-value: 0.5895

This suggests the fitted model is better than a null model. The model therefore explains returns in a statistically significant way.

None of the variables are statistically significant.

## **Chapter 6: DISCUSSION OF RESULTS**

The objective of the research was to gain an understanding of the economic consequences of escape FDI. Given that the economic consequences of escape FDI can have profound effects on the firm and its stakeholders, it is important to understand whether escape FDI is a positive or negative motive for investing abroad. This was presupposed through the two hypotheses, which will be discussed and deliberated on further in this chapter. Chapter 5 included and concluded on the results of the statistical analysis to confirm the hypotheses and achieve the objectives of this research. This chapter will probe and apply the results obtained to address the hypotheses and to understand the insights and impact of the economic consequences of escape FDI.

### **6.1 Context of the Study**

South Africa could be characterised as a country with high levels of corruption, political instability, lack of regulatory quality, a disregard for the rule of law and weak institutions. Countries that have high levels of corruption tend to experience low levels of economic growth (Stoian & Mohr, 2016). This is evidenced in South Africa where the country experienced a “lost decade” during the Zuma era from 2009 to 2018. The outcome has been stagnant growth and limited private and public investment. Inward foreign direct investment has dried up, caused by a perceived lack of rule of law and high levels of corruption. Compounding this is that firms operating in South Africa suffer from a lack of competitiveness because weak institutions push up the cost of doing business (Cuervo-Cazurra, Ciravegna, Melgarejo & Lopez, 2018).

Gao, Zuzul, Jones and Khanna (2018) argue that institutions are more than background conditions. They directly influence and shape the strategic actions taken by a firm (Buckley et al. 2007). North (1990) noted that they might even affect managers’ perceptions and possibly influence managerial behaviour towards the strategies an EMNE might pursue (Dunning & Lundan, 2008).

This resonates with institutional theorists who maintain that institutions also include informal rules and norms, specifically the preconscious cognitive and ideational elements that are embedded in culture and are widely accepted by society (Ahlstrom et al., 2014). This is fundamental because managers make the strategic decisions. Luo and Tung (2007, 2018) complemented this by noting that corporate executives have to be competent, skillfully manipulating their strategic choices within their domestic

institutional context, creating the space and the freedom to pursue the international strategies of their own choosing. An example of this is Naspers. Naspers is imbued with an entrepreneurial culture and together with the competence of its former Chairman, Koos Bekker, enabled the acquisition of Tencent, which is widely regarded as one of the best acquisitions in history (“Naspers,” 2018).

Cuervo-Cazurra and Ramamurti (2017) affirm this by noting that underdeveloped institutions result in an increase in operational costs and a reduction in investment. Together with lower levels of economic and institutional development, less stable political systems, prevalence of corruption and weak enforcement of regulations, the cumulative effect is that the EMNE operates in a volatile environment, and at a comparative disadvantage to its DMNE counterparts. The Chairman of WBHO, Mike Wylie, presciently stated, “Policy uncertainty, poor governance within state-owned entities and endemic corruption have strangled public infrastructure spending...while at the same time, low economic growth has stifled private investment in the country”. (WBHO Integrated Report, 2018, pg.5). Stagnant growth limits firms’ domestic expansion (Stoian & Mohr, 2016) and by implication, performance, which drives escape FDI.

FirstRand noted similar constraints, particularly around the South African macroeconomic environment, spotlighting policy ambiguity and political uncertainty as key issues weighing on domestic risk appetite and economic activity (FirstRand Integrated Report, 2018). Pioneer Foods described South Africa as a low growth economy, with low investor confidence and declining consumer disposable income (Pioneer Foods Integrated Report, 2018).

This is critical, because when firms find the environment stifling, they are pushed to invest abroad to escape and avoid these institutional limitations and market constraints (Marano, Tashman & Kostova, 2017). Firms are pushed to escape in search of growth as well as diversify their risk exposure to the home country.

Buckley, Chen, Clegg & Voss (2016) widened the strategic scope of managerial behaviour to include risk-taking, noting that culture plays a significant role in shaping a firm’s strategy. Risk-taking has been identified in the literature as a significant competitive advantage for EMNEs over their DMNE counterparts (Buckley, 2016). The fact that a significant number of firms have Africa at the heart of their internationalisation strategy supports this. Examples include MTN, Vodacom, Standard Bank & FirstRand.

Amighini et al. (2015) highlighted the tendency of Chinese firms to invest in countries characterised by weak institutions. The strategy for these affiliated Chinese firms is to negotiate where there are authoritarian regimes and greedy elites, enabling the firm to manipulate the host environment to extract economic rents from natural resources and thereby gain in size, resulting in exceptional performance. MTN exemplifies this strategy. By offering voice, messaging and data services over mobile networks to a host of African & Middle Eastern countries, MTN has been able to extract economic rents. An EBITDA margin of 35 per cent attests to this (MTN Integrated Report, 2018). This highlights the upside opportunities and potential economic rents that can be extracted from operating in emerging and frontier markets.

Guillen and Garcia-Canal (2009) argue that by operating in institutional voids, these managers develop non-traditional capabilities and learn to manage effectively in uncertain and risky environments. Through the process of learning, they develop non-traditional FSAs, which can be transferred to similar environments. This can give EMNEs a competitive advantage over their DMNE rivals and consequentially outcompete them (Cuervo-Cazurra, Luo, Ramamurti, Hwee Ang, 2018) in emerging markets. Managers who perceive the weak institutional environment and market constraints in South Africa as obstacles to overcome, have fundamentally developed and implemented emerging market internationalisation strategies.

## **6.2 Escape Foreign Direct Investment to Emerging Markets and Performance**

Cuervo-Cazurra and Genc (2008) were one of the first scholars to note home country institutional learning by emerging market firms. These firms had the ability to flourish in weak institutional environments and were able to transform home country competitive disadvantages into firm-specific advantages, being non-traditional in nature. Cuervo-Cazurra and Ramamurti (2017) coined this innovation-based or institutional learning based internationalisation and observed that this led to better outcomes as evidenced by firms' positive performance.

These new non-traditional FSAs included the ability of EMNEs to operate in difficult environments, develop a deep understanding of customer needs and the ability to make products economically (Ramamurti, 2012; Li, Yi & Cui, 2017). KAP epitomises this. KAP has focused on servicing customers in emerging markets, with specific focus on sub-Saharan Africa. The group leverages its deep industry knowledge and expertise



to maintain a competitive advantage in Africa (KAP Integrated Report, 2018). Mr Price has created value by focusing on the needs of its core customers and on good product execution (Mr Price Integrated Report, 2018).

As firms learn, they gain in knowledge and experience while operating in institutional voids. Vodacom depicts this, where it does not count Nigeria as one of its top markets. It can be argued that it has observed the difficulties that MTN has encountered in that host country, indicating that the firm has gained knowledge and experience whilst operating in Africa, which has had a positive impact on firm performance (Li & Sun, 2017).

Cuervo-Cazurra, Ciravegna, Melgarejo and Lopez (2018) found that firms operating in emerging markets with higher levels of uncertainty, specifically political uncertainty and corruption, perform better than their local competitors. They attribute this to an “uncertainty management capability”. This dynamic capability includes adaptability, flexibility and resilience (Cuervo-Cazurra, 2016). Sanlam and Shoprite offer good examples of these capabilities. Sanlam states that it has achieved its performance, which is a fitting tribute to its resilience, diversification and ability to execute under adverse conditions (Sanlam Integrated Report, 2018), while Shoprite refers to resilience on more than five occasions to describe one of its core cultural attributes (Shoprite Integrated Report, 2018). Pioneer Foods state that agile companies are able to take advantage of the opportunities that arise from operating in volatile inflationary environments (Pioneer Foods Integrated Report, 2018).

Uncertainty in the environment, including regulatory uncertainty, corruption and potential political shocks pose a threat to firms, and have to be managed constantly (Gao, Zuzul, Jones & Khanna, 2017). These characteristics highlight the risks and downside of operating in institutional voids. Mr Price and Shoprite exemplify how to manage appropriately in an environment of uncertainty.

Mr Price manages its investment exposure to Nigeria by restricting stock flow and repatriating cash, spotlighting the fact that it manages the working capital cycle very carefully (Mr Price Integrated Report, 2018).

Shoprite also cannily manages its exposure to Africa. This can be argued because it has almost the same number of stores in Lesotho (25) as it does in Nigeria (24), despite the fact that Nigeria is about 30 times the size of Lesotho. Furthermore, lack of infrastructure, exchange controls and foreign exchange shortages create major

obstacles, which have to be overcome, and managed constantly (Shoprite Integrated Report, 2018).

Nampak offers an example of a company that did not manage the uncertainty in its environments appropriately. Nampak counts Nigeria and Angola as two of its key international markets. Both rely heavily on oil for the majority of their revenues. When the price of oil fell from US\$98 to US\$52 in 2014, this triggered a liquidity crisis in both countries as the availability of dollars dried up. The outcome was that its customers couldn't pay the firm. Nampak was faced with a liquidity and debt crisis (Nampak Integrated Report, 2018). Nampak has not sufficiently diversified geographically, and is overly reliant on the home market, together with Angola and Nigeria, for its revenues and profits. The share price has been re-rated down due to the inherent risk in the Group's exposure to both economies. This has resulted in value destruction.

MTN is a case study in how external shocks can negatively affect a firm's performance. MTN counts Nigeria as its largest market and is the number one service provider in Nigeria. Like Nampak, MTN experienced the same external shock in 2014. The outcomes, however, were different. Faced with a chronic shortage of foreign currency, the government became predatory as it sought alternative sources of revenue. It could be argued that MTN was perceived by the Nigerian government as a potential source of revenue or "soft target" and through its regulators imposed a US\$5.2 billion fine on the firm. There is no dispute resolution mechanism in Nigeria and MTN was forced to negotiate with the government. MTN eventually settled and paid over US\$1 billion. The inherent risk of operating in Nigeria is baked into its share price, which has also been re-rated down, wiping billions off MTN's market capitalisation in the process.

Firms also rely on country-specific advantages to construct their ownership advantages. A particularly potent country-specific advantage relates to capital market imperfections, including intra-business cross-subsidisation, which gives EMNEs access to cheap capital that enables their international expansion (Buckley, 2018). EMNEs may also dominate in their home country markets, creating further financial resources (Madhok & Keyhani, 2012). They therefore have significant resources available for acquisitions and greenfield projects. This is demonstrated by companies such as Standard Bank, Absa, First Rand, Nedbank, MTN and Vodacom. An oligopolistic position in South Africa has enabled these firms to generate the resources required to fund their international expansion.

EMNEs have significant resources available for acquisitions. Access to ample funding reduces the financial and commercial risks associated with international investment projects and enables the acquisition of less profitable brand- and technology-seeking assets, especially in developed markets (Buckley, 2018). Contractor (2013) goes further by stating that some acquisitions are wasteful, have loaded EMNEs with high debt, do not improve profitability and ultimately destroy shareholder value over the long term.

Pick n Pay's acquisition of Franklins is a classic example of an acquisition of a less profitable asset. Franklins was a general supermarket chain consisting of 77 stores, operating in New South Wales, Australia ("Franklins," 2001). Franklins lacked the scale that its competitors had and consequentially could not compete effectively, leading to losses, which ultimately destroyed shareholder value (Pick n Pay's performance still poor, 2013).

Netcare's acquisition of the GHG Group was equally wasteful. Netcare maintains an oligopolistic position in its home market. Its ownership advantages are based on non-transferable country-specific advantages (hospitals and related locations), which arose as a direct result of an institutional void; dysfunction and collapse of the public health system. GHG is the largest private hospital group in the UK. Netcare acquired GHG before the financial crisis when demand was strong on the back of NHS referrals and contracts, and private medical insurance (PMI), which is essentially top-up insurance. When the financial crisis of 2007-2009 erupted, real wages declined and demand melted away. The acquisition became a drag on management's time and profitability and was sold in 2017 after taking a massive write-down of R10.7 billion (Netcare Integrated Report, 2018). The key issue was that Netcare lacked the required ownership advantages to compete effectively, leading to value destruction.

Host country institutional environments are not homogeneous, but heterogeneous and differ according to different levels of economic development, which, in turn, influences the strategic decisions of foreign investors (Wang & Li, 2018). The implication of this is that the host country's institutional environment has a significant influence on location choice for multinationals. Cuervo-Cazurra, Ciravegna, Melgarejo and Lopez's (2018) final finding was that firms perform better when they expand regionally into countries that tend to have similar institutional environments and are of lower psychic distance.

A significant number of firms have chosen an African internationalisation strategy as the foundation for their overall international expansion strategy. Africa is a compelling

investment destination with vast markets, consisting of over one billion potential consumers, together with fast growing economies, characterised by rapidly urbanising and increasingly affluent populations. These include MTN, Vodacom, Mr Price, Standard Bank, Absa, Nedbank, FirstRand, Shoprite and Pick n Pay, to name a few. Shoprite cites the considerable economic opportunities that Africa offers (Shoprite Integrated Report, 2018).

Hernandez and Guillen (2018) found that monopolistic or oligopolistic behavior forces competing firms to follow one another into foreign markets. This is exactly what is found in the study. In the Information & Communications Technology industry, Vodacom followed MTN into Africa, in Financial Services, Standard Bank, Nedbank, Absa & FirstRand have followed on another into Africa. A final example is in Food Retail, where Pick n Pay reconfigured its international strategy by jettisoning Franklins and Australia and followed Shoprite into Africa. It is no co-incidence that this reconfiguration of its international strategy has coincided with its improved financial performance and lies at the heart of Pick n Pays turnaround.

Firms may discount cultural distance in their strategic deliberations if the market potential is compelling enough (Lebedev, Peng, Xie & Stevens, 2015). Naspers' acquisition of Tencent fits this description. Tencent is a Chinese firm, situated in a market with over one billion potential consumers.

EMNEs' expansion path may be dual in nature, with simultaneous investments in both developed and developing markets (Luo & Tung, 2018). Pioneer Foods is a classic example. While carefully exploring African markets, it is also pursuing acquisitions in the developed world. The motive may appear to be market seeking, but it can be argued that the underlying motive is to diversify its exposure to high-risk Africa, and invest in more stable developed environments, being escapist in nature.

South Africa is currently experiencing stagnant growth and no investment. Stagnant growth limits firms' domestic expansion (Stoian & Mohr, 2016) and, by implication, performance (as noted above). South African EMNEs that are overly reliant on the South African market and, by implication, have not diversified geographically sufficiently have suffered. Their issues are aggravated by the fact that their performance is heavily influenced by the business cycle, which is outside of their control.

Mining, manufacturing and construction firms are affected by the business cycle. As trade is being impacted by the trade war between the United States and China and

growth in Europe slows, global demand for commodities has waned. Regulatory issues have exacerbated the situation, particularly the proposed new Mining Charter, whereby it is proposed that empowerment ownership be increased from 26 per cent to 30 per cent. This has led to an investment strike. Kumba Iron Ore, Impala Platinum, African Rainbow Minerals, Harmony Gold and Assore have all experienced declining financial performance in tandem with declining commodity prices. Mining firms have not performed.

ArcelorMittal is not only impacted by the business cycle, but also by a South African market with little to no investment. Chinese steel production capacity has increased during a period where there is declining demand for steel. This has led to dumping, where Chinese firms have flooded the market with cheap steel, sold at below the cost of production. The consequences have been devastating. No demand due to little to no investment and cheaper sources of steel on the supply side has pushed ArcelorMittal towards bankruptcy (ArcelorMittal Integrated Report, 2018). The firm has only survived due to the governments imposition of tariffs on imported steel. ArcelorMittal is overly reliant on South Africa and has resorted to protectionism in this extreme case.

Construction has ground to a halt as a result of little to no investment. The industry is facing a crisis. Group 5 has not diversified sufficiently and is overly reliant on South Africa. This has had catastrophic consequences as the firm has been forced into business rescue. Around 3 894 jobs will be lost (Group 5 Integrated Report, 2018). This will not only affect the employees directly and families indirectly, but the associated wider communities as well.

The main theme that emerges is that firms that have performed well have internationalised regionally (predominantly Africa). Monopolistic or oligopolistic behaviour forces these firms to follow one another. These firms operate in many host countries and have achieved scale and scope. This enables these firms to diversify their risk exposure to any one host country sufficiently. This ensures that the firm is not overly reliant on one or two host countries for its revenues and profits. If sudden shocks occur, they do not threaten the survival of the firm. Managers view their investments as a portfolio and are managed accordingly. Managers understand that their investments are heterogeneous, and performance will vary at individual investment level. Financial performance is monitored and managed at host country level but, more importantly, reported on at portfolio level.

EMNEs are heterogeneous (Amighini et al., 2015) and generalisations are insufficient. Furthermore, a firm's ability to exploit resources depends upon its place in time and space (Barney, 1991) and consequentially context matters in a firm's strategies related to internationalisation, particularly location choice and mode of entry. Barney (1991) also states that firms within an industry may be heterogeneous and therefore performance will vary among firms operating in the same industry. That is what is found by analysing firms that escaped to emerging markets. Firms created and destroyed value fairly evenly.

### **6.3 Escape Foreign Direct Investment to Developed Markets and Performance**

Managers perceive uncertainty in the environment as a threat (Gao, Zuzul, Jones & Khanna, 2017), leading them to limit their exposure to the home country (Barnard & Luiz, 2018). Managers take the firm abroad to avoid precarious conditions at home, including market constraints, restrictions and institutional misalignment, and fragility (Shi, Sun, Yan & Zhu, 2017; Buckley, 2018). Cuervo-Cazurra and Ramamurti (2017) cite underdevelopment of home country conditions as a strong motivation for escape-based internationalisation. Managers are pushed to invest in developed markets with stable institutions.

Firms are concerned about political stability. Managers fear sudden changes in policies and actors reneging on existing contracts (Cuervo-Cazurra & Genc, 2008). In South Africa, debate around the Mining Charter is eroding local and foreign investor confidence and has led to an investment strike. Absa has cited policy uncertainty in South African as a barrier to investment (Absa Integrated Report, 2018). Global mining houses such as Anglo American plc have limited their exposure to South Africa.

Rule of law is paramount for international investors, especially with regard to property rights. In South Africa, the issue of expropriation of land without compensation is particularly relevant and touches on rule of law directly. The government is proposing changing Article 25 of the Constitution to give life to this policy. Pioneer Foods has raised Land Reform as a cause of lack of investment. Farmers have adopted a "wait and see" approach which exacerbates the investment strike, possibly leading to diminishing employment opportunities (Pioneer Foods Integrated Report, 2018).

EMNEs tend to have weaker and less robust FSAs than their DMNE counterparts in terms of generating sustainable above-average returns (Madhok & Keyhani, 2012),

such as proprietary technology or brands (Ramamurti & Hillemann, 2018). Their competitive advantages tend to be efficiency and natural resource based (Madhok & Keyhani, 2012). South African firms that perform well confirm this.

Oceana is ranked as one of the top 10 seafood companies in the world. It operates in the US through Daybrook Fisheries. According to Luo & Tung (2007), this firm would be classified as a niche firm because it focuses on a narrow line of products to leverage their strengths (Oceana Integrated Report, 2018).

Bidcorp is a broad-line foodservice distribution group, which depends on economies of scale to generate profits. This is also a niche firm. EMNEs that invest in developed markets with liberalised economies face increased rivalry and intensified competition (Deng, Yan & Van Essen, 2018). Bidcorp faces intense competition, even though it operates in a niche market. This is evidenced by the fact that in 2018, it only managed to generate five per cent operating profit on over R119 billion in revenues (Bidcorp Integrated Report, 2018).

Mondi, Sappi, Discovery, Investec, Finbond and Aspen are predominantly niche actors. They have created value due to geographic diversification and product specialisation. Mondi has transformed itself into a global packaging and paper company, specialising in fibre and consumer packaging (Mondi Integrated Report, 2018). Sappi has followed in Mondi's footsteps and is transforming. Sappi now refers to itself as a global diversified woodfibre company (Sappi Integrated Report, 2018). Cellulose is made from woodfibre (pulp), which is used to manufacture clothing. The margins for clothing are higher than for paper, which is positive. Global demand for paper is decreasing, and both Mondi's and Sappi's transformations are viewed positively.

Discovery has introduced Vitality into developed markets where it is being well received (Discovery Integrated Report, 2018). Finbond has hyper-specialised in secure lending in North America, focusing on Auto Title loans (where the borrower provides the car as collateral for the loan) (Finbond Integrated Report, 2018). Investec specialises in serving the premium market in the UK, offering asset management, wealth and investment and specialised banking (Investec Integrated Report, 2018).

Aspen is a leading speciality and branded multinational pharmaceutical company, treating a broad spectrum of acute and chronic conditions. The Group has specialised in its product offering, such as anaesthetics, thrombosis, high potency and cytotoxics complemented by regional brands. To supplement its product specialisation, it has diversified globally (Aspen Integrated Report, 2018).

Spar's operating performance in Ireland and Switzerland further reinforces the consequences of intense competition. Both divisions reported operating profits of around two per cent (Spar Integrated Report, 2018). It is argued that this is below the cost of capital, and the impact of these investments on Group profitability is negative, dragging overall profitability down.

EMNEs may have weaker FSAs due to being younger MNEs relative to DMNEs, which translates into a latecomer disadvantage. A consequence of this is that the firm lacks brand recognition. When Discovery entered the US market, it faced this issue and it subsequently failed due to lack of brand recognition.

A further disadvantage of being a latecomer, is that EMNEs may lack effective managerial skills. Their managerial capabilities may not be sufficient or good enough when operating in more advanced and competitive economies, leading to a deficit in managerial capabilities (Madhok & Keyhani, 2010). This may lead to inadvisable and undesirable acquisitions (Buckley, 2018). EMNEs end up overpaying for their acquisitions.

A classic example of this is the Gourmet Burger King (GBK) acquisition by Famous Brands in 2017. GBK is a signature branded burger franchise business in the UK. In 2018, only one year later, the group impaired the goodwill, implying that it had overpaid for the acquisition. It cited an oversupply of restaurants as landlord's continued to replace failing retailers with more food offerings as well as online competition and resultant low barriers to entry as significant causes of underperformance (Famous Brands Integrated Report, 2018).

Incredibly, it noted that consumer sentiment was subdued because of uncertainty around Brexit. Brexit occurred in 2016, before Famous Brands concluded the transaction. This was most certainly an undesirable and value destroying acquisition.

Wang et al. (2014) found that domestic institutional constraints have psychological consequences for executives. They may exhibit behaviours associated with overconfidence within their firms. This can affect decision-making negatively. If one factors in what Deng and Yang (2015) established; that escape FDI is further rationalised when there are ample markets for acquisition, and that EMNEs invest in advanced countries to gain access to established brands, the consequences could be disastrous.



Such was Woolworths acquisition of struggling Australian department store David Jones in 2014. This was the largest acquisition by a South African retailer to date. In 2018, Woolworths impaired a third of the investment. According to the CEO's report (Woolworths Integrated Report, 2018), falling footfall and intense competition from online retailers contributed to weak performance.

Having witnessed local rival Edcon experience the same phenomenon, why would Woolworths buy an Australian version of Edcon? In addition to what Wang et al. (2014) and Deng and Yang (2015) state, Lebedev, Peng, Xie and Stevens (2015) suggest perverse incentives (such as linking executive pay to firm size) and a high degree of management hubris may influence management decision-making.

Furthermore, Hoskisson, Wright, Filatotchev and Peng (2013) observed Chinese MNEs' outbound FDI to developed markets was based on incentives to overcome home country factor markets and institutional voids. They found that these investments failed. Similarly, to Famous Brands GBK acquisition, the David Jones acquisition failed.

This is what is found by analysing Truworthis' acquisition of Office, which operates in the UK, Germany and Ireland. Office targets the 16 to 25-year-old fashion footwear mid-level price range segment of the market. This segment of the market is price sensitive and dependent on the performance of the economy. Depressed consumer confidence and a slowdown in the economy due to Brexit and Europe in general has resulted in underperformance, dragging down overall performance. There is a material difference in EBITDA margins in the emerging market division (28 per cent) and the developed market division (8 per cent) (Truworthis Integrated Report, 2018). Truworthis' acquisition of Office is considered a failure by the market, depressing Truworthis' share price.

The Foschini Group (TFG) has implemented a niche multi-acquisition international investment strategy. TFG has targeted very niche branded segments for acquisition. To illustrate the point, these include brands such as Connor, the fastest growing on-trend menswear brand in Australia aimed at the value market. G-Star Raw, authentic denim wear targeted at the premium market. Hobbs, established luxury brand targeted at busy, smart women in London. Johnny Bigg, an on-trend menswear brand targeted at the mid-market. This illustrates that TFG diversifies further by product specialisation as evidenced by targeting value, mid-market and premium segments in both Australia and London (TFG Integrated Report, 2018).

It is worth noting that its EBITDA margins in London (8 per cent) and Australia (13 per cent) are well below South Africa's (20 per cent). These EBITDA margins are the same as those of what Truworths is generating in the UK, but the market has rewarded TFG as evidenced by an increased share price and market capitalisation. It can be argued that the market is rewarding TFG for both product and geographical diversification, whereas it is punishing Truworths for product concentration.

Perverse incentives, such as linking executive compensation to firm size and hubris exacerbate firms' appetite for foreign investments (Lebedev, Peng, Xie and Stevens, 2015). Sasol is a further example of potential negative outcomes as a result of management hubris and careless risk analysis. Ample cheap funding reduces the financial and commercial risks associated with international investment projects and enables less profitable international investments, especially in developed markets through subsidisation (Buckley, 2018).

Sasol is a chemical giant and was once one of South Africa's national champions. Sadly, the Lake Charles Chemical Plant (LCCP) investment has damaged its reputation and wiped out half its market capitalisation. According to the market, Sasol was hubristic, dedicating insufficient management time and resources to the project, leading to a staggering US\$13 billion cost overrun. As at November 2019, the results of the formal investigation had not been released, so the technical reasons for the overruns are unknown.

Akin to EMNEs that invested in emerging markets, EMNEs from South Africa that have not diversified sufficiently, either geographically or by product, and are overly dependent on South Africa have not performed. Imperial Logistics is overly reliant on South Africa and has underperformed as a result.

Earlier scholars such as Madhok and Keyhani (2012) observed that EMNEs that internationalised to developed markets tended to create their competitive advantages on efficiency or natural resources-based business models rather than monopoly based business models.

This is still relevant, but the significant theme that can be observed is that firms that specialise (product and geographically or both) and become niche actors perform as evidenced by value creation. Firms that have not specialised in their internationalisation strategy tend to have destroyed value. Firms that have not sufficiently diversified, either by-product or geographically and are overly reliant on the South African market have

also performed poorly, similarly to their South African peers who invested insufficiently in emerging markets.

#### **6.4 Emerging Market versus Developed Market Performance**

South African EMNEs operating in emerging markets created 89 per cent of value creation (R1.7 trillion) compared with 11 per cent (R0.2 billion) created by South African EMNEs operating in developed markets. Even after adjusting for Naspers, South African EMNEs operating in emerging markets created twice (67 per cent) the value their counterparts operating in developed markets (33 per cent) created.

Emerging markets such as China and Africa are colossal markets with over two billion potential consumers. They offer enormous opportunities to exploit and can generate immense economic gains, well in excess of what could be achieved in competitive markets, defined as economic rents, but there is a corollary: they have a higher risk profile. The level of inherent risk increases fundamentally. Firms operate in environments with higher levels of uncertainty and are constantly exposed to institutional voids. MTN and Naspers attest to the fact that these risks can materialise suddenly and that these environments have to be managed constantly (Gao, Zuzal, Jones & Khanna, 2017).

Naspers' 2018 financial year is evidence of the reality of such risks. Video games are Tencent's single biggest revenue source. According to an article in *The Economist* (Tencent's kingdom is under assault from China's regulators, 2018), it was reported that myopia had worsened and that eye strain is an increasing problem. President Ji Jinping asked the Ministry of Education to address the problem. In August 2018, the Ministry of Education took action, restricting the number of total online games as well as that of new releases. Tencent's stock tumbled by 5.6 per cent the following day and shaved off US\$20 billion in one day. In total, between 2018 and September 2019, Naspers lost R522 billion in market capitalisation. It has still managed to create R700 billion in market capitalisation from 2013.

This was not the first sudden change in regulation that Tencent suffered in 2018. In March 2018, regulators froze new game approvals without explanation. These two experiences demonstrate the risks of operating in emerging markets where the firm is exposed to regulatory voids, which arises from excessive forms and levels of regulation (Enderwick, 2016).

Buckley et al. (2007) noted that high political risk is associated with low FDI inflows, but if the higher-risk host countries offer higher returns, then investment will still flow to them. Allied to this is for firms to specifically seek out authoritarian regimes and greedy elites where they can extract rents, gain in size and deliver exceptional performance (Amighini et al, 2015).

This is the tale of mobile network provider MTN. MTN has chosen an emerging market internationalisation strategy focused on Africa and the Middle East, and it generates returns that can be defined as rent extraction.

With high returns come high risk, especially if the firm is operating in highly corrupt and predatory environments. If the firm associates itself with some of the world's worst regimes, the firm must accept the political risks associated with them. As a result, despite generating economic rents, MTN has had R142 billion wiped off its market capitalisation because of its exposure to Nigeria and the concomitant political risk.

FirstRand, Standard Bank, Sanlam, Vodacom, Nedbank, Absa, Shoprite and Mr Price demonstrate the upside of an African international investment strategy. These firms maintain oligopolistic market positions in South Africa. These firms have access to cheap capital, which has enabled these EMNEs to grow quickly, and gain in scale and scope (Buckley, Elia & Kafouros, 2014). Their market dominance in South Africa has allowed them to accumulate significant financial resources (Madhok & Keyhani, 2012). This places further resources at their disposal for making acquisitions and undertaking greenfield projects, which has enabled their expansion (Buckley, 2018).

It can be argued that compared to the rest of Africa, these firms have potent FSAs such as cutting-edge technology and non-traditional FSAs, such as resilience. These firms face little to no local or international competition in most of the host countries in which they operate in because of lack of infrastructure, including lack of access to first-world shopping experiences (Shoprite Integrated Report, 2018).

These firms operate in multiple host countries where they have achieved economies of scale, gaining in scale and scope, which has enabled them to diversify geographical risk effectively. These firms have diversified across Africa and they treat their investments as a portfolio. These firms have augmented their ownership advantages (Dunning, 2001) and exploited the opportunities that have arisen because of their place in time and space (Barney, 1991). Consequentially, these firm have maintained their oligopolistic and even monopolistic positions in most of the host countries in which they

operate, capturing economic rents in the process that sustain phenomenal performance.

Expanding into Africa requires considerable resources to fund capital and operational expenditure requirements, and to survive sudden economic shocks such as liquidity crises, when they occur. These shocks put tremendous pressure on the working capital cycle. It is noted that Africa is not a union like the European Union, but 54 separate countries, and by nature, a fragmented market. These firms have the resources and capabilities to cope with and respond to these shocks and concomitant volatility as and when they arise. These firms have the financial resources to fund a volatile working capital cycle.

Operating in Africa requires a tremendous amount of management time, expertise and resilience to deal with the nature of the challenges as and when they arise. These firms have the required FSAs to navigate the countless demands, challenges and complexity that arises from operating in Africa. To put this into context, Shoprite cites in its 2018 Integrated Report, that it works with 19 974 suppliers.

By contrast, Bid Corporation, Discovery, Sappi, Mondi, TFG and Aspen have diversified their home country risk by investing in developed markets. These firms have to a large extent specialized, either by product or geographically or both. These firms can be considered niche actors. They also, to some degree, view their investments as a portfolio.

Compared with their peers who chose an emerging market international investment strategy, these firms mostly lack market power and therefore are not oligopoly or monopoly based, but as cited in the literature efficiency or resource based. Complimenting this, what was found in the study was that the successful firms have found niches in markets where they operate.

Their competitive advantages in advanced economies and resultant returns are efficiency or natural resource based (Madhok & Keyhani, 2012) or niche based, as observed in this study. The markets that they operate in are characterised by rivalry and competition (Deng, Yan & Van Essen, 2018) and the resultant economic gains are considered to be normal returns generated in competitive markets. Cut-throat competition drives down prices and profits. This is evidenced by the returns of firms that operate in developed markets. These firms' performance is comparatively poor when compared to the rents extracted by their peers that operate in emerging markets.

To illustrate the point, consider Bid Corporation. This firm was the best-performing EMNE operating in developed markets in terms of value creation, as measured by an increase in market capitalisation. On R119 billion revenues, it generated R6n in operating profit or five per cent in 2018. It created R93 billion in value between 2013 and 2018. MTN was the worst-performing EMNE operating in emerging markets during the same period. It destroyed R143 billion in market capitalisation. It generated a 35 per cent operating profit in 2018.

## **6.5 Additional Results**

### **6.5.1 Risk**

The total number of firms in the population was initially 102, which was reduced by 17 firms to a final population of 85 firms analysed. There was an fairly even split of firms investing in emerging markets, with a level of investment in developed markets of up to 20 per cent, being 51 firms (60 per cent) and firms investing in emerging markets with a scale of investment in developed markets in excess of 20 per cent, being 34 (40 per cent).

These findings are consistent with Buckley et al.'s (2007) groundbreaking study of outbound foreign direct investment by Chinese firms. A key finding in that study pertained to risk and risk tolerance. Chinese firms were selecting host countries to invest in with similar institutional and political environments to China, indicating a different and higher risk profile than expected.

The scholars postulated that institutional factors might have shaped their attitude towards risk. This was diametrically opposed to the risk appetite observed among developed firms. Ramamurti and Hillemann (2018) observed that Chinese firms prefer host countries with high political risk relative to host countries with low political risk. Investment patterns of South African multinationals support those observations. Buckley et al. (2016) have noted that the international business literature has identified risk-taking as a significant competitive advantage for EMNEs over their DMNE counterparts. The fact that the top performing firms that enjoy an oligopolistic position in the South African market as well as in most of the host countries that they operate in, corroborates what is found in the literature.

### **6.5.2 Age**

Age of the organisation is shown to have a significant impact on the firm's likelihood of success or failure and is statistically significant. In measuring absolute value creation or destruction, two of the performance metrics of firm performance are market capitalisation and share price, which are both stock market related indicators.

A stock market based metric is appropriate because one of the objectives of the study is to determine whether there has been medium- to long-term value creation or destruction at firm level. Market capitalisation is a metric used in this study to measure firm performance. In both market capitalisation and share price, firms older than 30 years are shown to have a higher likelihood of failure.

Furthermore, when analysing relative performance of firms investing in emerging markets compared to firms investing in both emerging and developed markets (excluding outliers), according to both Share Price and Market Capitalisation metrics, age is also statistically significant. In line with absolute value creation or destruction, firms older than 30 years perform relatively poorly compared with firms younger than 30 years.

This conforms to the current literature where Amighini et al. (2015) emphasised that EMNEs' motives for investing in developing markets are mainly for resource seeking, efficiency seeking and market seeking. The reason for this is that younger EMNEs' firm-specific advantages (FSAs) are likelier to be more dependent on location-specific advantages because they have not had time to accumulate non-location bound FSAs, such as cutting-edge technology or global brands (Ramamurti & Hillemann, 2018). Younger multinationals are established firms, with firm-specific advantages and capabilities. This is evidenced by their ability to acquire foreign acquisitions, which requires financial resources (Zhang et al., 2018)

A further factor is the global context for internationalisation. Rapid internationalisation by younger EMNEs could be due to a more conducive global context rather than an attribute of EMNEs (Ramamurti, 2012). This is because in the 1990s the barriers to entry and associated internationalisation were significantly reduced through trade liberalisation. In the global context, both costs and risks of internationalisation were drastically reduced, and previous barriers became gateways to internationalisation (Ramamurti & Hillemann, 2018) as governments liberalised their economies and sought foreign direct investment. This created opportunities for younger firms as

governments offered preferential treatment to foreign firms to attract investment (Li & Sun, 2017).

In a study of 29 000 firms in 120 Chinese cities, the researchers found a relationship between age and performance. There is a positive diminishing relationship as well as a U-shaped relationship between firm age and firm performance in institutionally less developed environments. This is because older firms create institutional relationships over time, while gaining knowledge and experience, which has a positive impact on firm performance. This is constrained with time and the positive effect on performance will reach a limit at some point in time (Li & Sun, 2017), indicating that being over a certain age will have a negative effect on performance.

It can be argued that as a firm ages, organisational adaptability decreases and is low because of culture and legacy structures, whereby the firm may suffer from inertia and path dependence (Guillen & Garcia-Canal, 2009).

### **6.5.3 Size**

Size of the organisation is shown to have a significant impact on the firm's performance. In absolute terms based on market capitalisation and share price profitability metrics, size of the firm is shown to have a statistically significant impact on the firm's likelihood of failure. The larger the firm is in terms of market capitalisation, the more likely the firm is to create value. Firms that are smaller relative to larger firms are more likely to destroy value.

EMNEs may possess strong capabilities, including tangible assets, because of diverse home country-specific advantages (Buckley, Elia, & Kafouros, 2014). Having an oligopolistic market position such as Vodacom and MTN in the mobile network space in South Africa and access to cheap capital have enabled these EMNEs to grow quickly and gain scale and scope. Alternatively, the substantial growth in capital markets (particularly in emerging markets) enabled EMNEs to raise capital, which partly explains the significant spurt in outbound foreign direct investment, which also allowed these EMNEs to grow quickly through acquisitions (Contractor, 2013).

Large firms perform better because they have stronger bargaining power, especially when entering other emerging markets where they face limited local or no developed market rivals. Larger firms are able to exploit economies of scope and scale, which enables superior performance (Buckley, Elia, & Kafouros, 2014).



Complementing their recurrent market dominance in fast-growing domestic markets, EMNEs acquire significant financial resources (Madhok & Keyhani, 2012). Fast-growing domestic markets fuel the growth of domestic firms, enabling them to achieve scale and scope. This places resources for making acquisitions at their disposal.

Amighini et al. (2015) highlight the tendency of Chinese firms to invest in countries characterised by weak institutions. The strategy for these affiliated Chinese firms is to negotiate where there are authoritarian regimes and greedy elites, enabling the firm to manipulate the host environment to extract economic rents from natural resources and thereby gain in size, resulting in exceptional performance. These strategies may be mimicked by firms from other emerging markets, such as South Africa.

The objectives of this study were to gain an understanding and insights into the economic consequences of escape FDI. The study was concerned with firms' internationalisation strategies, notably location choice. The study sought to answer the quintessential question of whether the firm would be better advised to internationalise to other similar emerging markets where it has a better understanding of the institutional environment and is able to compete more effectively, or would the firm be better advised to internationalise to more stable environments in the developed world? The objectives of the study have been achieved.

## **Chapter 7: CONCLUSION**

This chapter contains the principal consolidated findings of the research study, the implications that may be of benefit to managers of businesses in devising internationalisation strategies, the inherent limitations of the research as well as suggestions for future research and the theoretical foundations based on the findings of the study.

Escape foreign direct investment as a motive for internationalisation by South African MNEs has profound implications for both individual firms and for the country as a whole, both economic and socioeconomic. Institutional theory has formed the foundation of this study as scholars have highlighted that a market-based institutional framework has been taken for granted (Peng, Wang, Jiang, 2008).

In recent years, scholars have focused more sharply on home and host country institutional environments. Institutional environments have come to be viewed as

fundamental, directly influencing and shaping foreign investment decisions. Cuervo-Cazurra and Ramamurti (2017), Buckley (2018), Cuervo-Cazurra, Luo, Ramamurti, and Hwee Ang (2018), and Barnard and Luiz (2018) have focused on underdeveloped institutions and home market constraints and how the presence and significance of institutional voids and market constraints are fuelling escape-based internationalisation.

Managers perceive the uncertainty of the environment as a challenge that needs to be overcome and they take the firm abroad to avoid precarious conditions at home, including restrictions, market constraints, misalignment and fragility (Cuervo-Cazurra & Ramamurti, 2017; Shi, Sun, Yan & Zhu, 2017; Buckley, 2018), leading them to limit their exposure to the home country (Barnard & Luiz, 2018). Stoian and Mohr (2016) found that firms that felt constrained by the home market internationalise to escape the comparative disadvantages of operating in the home market.

One strategic response is to escape to other emerging markets with similar institutional voids and political risk. Buckley et al.'s 2007 seminal research found that Chinese firms prefer host countries with high political risk to those with low political risk. The authors proposed that institutional factors might have induced a perverse sense of risk.

Compared with their peers, contrarian managers perceive uncertainty as a threat (Gao, Zuzul, Jones & Khanna, 2017), and their strategic response is to escape to developed markets which are perceived to be more stable. This is supported by Cuervo-Cazurra and Ramamurti (2017), who argued that there is significant motivation for firms to escape constraining home country conditions and move to a more attractive and stable foreign location(s). Cuervo-Cazurra, Luo, Ramamurti and Hwee Ang (2018) argue that EMNEs are more likely to invest in countries with stable institutions (proxy for developed markets). This implies that these firms have an inherently different risk profile.

Gaining an understanding and insight into the economic consequences of escape FDI can assist managers in designing appropriate internationalisation strategies for the firm. It can have a profound influence on the firm, possibly assisting in preventing value-destroying strategies, which can have dire consequences for the firm or, more promisingly, enable value-creating strategies. Certain findings have shown that incorrect firm strategies can have critical consequences for employees of firms as well as the wider stakeholder community.

## 7.1 Principal Findings

Cuervo-Cazurra, Ciravegna, Melgarejo and Lopez (2018) noted that prior studies that tested the relationship between internationalisation and performance were based on observing DMNEs, which have dominated the debate. Their study of 536 publicly traded Latin American firms based in Brazil, Chile and Peru has been one of a few studies that has tested the relationship between internationalisation and performance of private EMNEs. The results of their study are in a specific context, notably South American. To date, EMNE outbound FDI and performance have received barely any attention in the literature and the studies.

This study intended to understand the relationship between escape FDI and performance by South African multinational firms, and whether it would be economically better to escape to other emerging markets or to escape to more attractive and stable locations in developed markets. The study intended to prove a relationship through a confirmatory test. Descriptive statistics as well as statistical analysis were performed. The linear regression statistical analysis was performed on each of the five dependent variables, measures of performance, being Share Price, Market Capitalisation, Return on Assets, Return on Shareholders' Funds and Tobin's Q for both hypotheses.

Hypothesis 1 was concerned about absolute value creation or destruction at firm level and was not concerned with the quantum of value creation or destruction. The descriptive statistics showed that firms are heterogeneous (Amighini et al., 2015) and generalisations are insufficient.

The population consisted of 85 firms, of which 51 (60 per cent) can be classified as investing in emerging markets and 34 (40 per cent) can be classified as investing in developed markets. In total 46 (54 per cent) firms created value (28 emerging and 18 developed), and 39 (46 per cent) destroyed value (23 emerging and 16 developed). A firm's ability to exploit resources depends upon its place in time and space (Barney, 1991) and consequentially context matters in firm strategies related to internationalisation, particularly location choice and mode of entry. That is what is found in this study by analysing firms that escaped to emerging markets and developed markets. None of the variables in the analysis were found to be statistically significant. Firms created and destroyed value fairly evenly. This resonates with the current literature, whereby Zhang et al. (2018) noted that where prior studies explored internationalisation and performance, the results were diverse.

Aybar and Ficici (2009) noted in their findings that in more than half the of the transactions analysed, international expansion through acquisition destroyed shareholder value. Contractor (2013) argued that some acquisitions are wasteful and do not improve profitability. In this study, 66 of 85 firms were analysed (77 per cent) to gain an understanding of individual firm performance. The results are in line with the literature in that performance of the acquirer firm subsequent to the acquisition was varied. Buckley (2018) argued that capital market imperfections may play a role. Access to cheap money enables the subsidisation of potentially less profitable acquisitions, especially in industrialised countries. Cheap money also enables EMNE firms to bid higher for targets. This may be why EMNE firms bid higher for targets than their DMNE counterparts (Lebedev, Peng, Xie & Stevens, 2015). The analysis of the results found this to be aligned to what is found in the current literature.

Hypothesis 2 was concerned about the quantum of value creation and the aggregate performance of EMNEs classified as operating in emerging markets relative to EMNEs classified as operating in developed markets. In the period under analysis, R1.9 trillion in value was created as measured by an increase in market capitalisation of aggregate firm performance between 2013 and 2018. Of this, R1,7 trillion (89 per cent) was created by firms operating in emerging markets and R0.2 billion (11 per cent) was created by firms operating in developed markets. Naspers skews these descriptive statistics because it alone created R1.2 trillion during the period. Even after adjusting for Naspers, emerging market firms created twice the value (R429 billion) of developed market EMNEs (R214 billion). The p-value of 0.08409 is statistically significant at a 10 per cent level of significance.

Size of the firm is shown to be statistically significant. Larger firms perform better because they have greater bargaining power and they can exploit economies of scale and scope (Buckley, Elia & Kafouros, 2014). They are also able to exploit their FSAs in international markets, especially in other emerging markets (Williamson & Wan, 2017).

Age of the firm is shown to be statistically significant. Firms younger than 30 years perform better than firms older than 30 years. This diverges from the notion that older firms perform better because they have had more time to accumulate FSAs (Ramamurti, 2012), while gaining in knowledge and experience. It can be argued that globalisation, rapid liberalisation and the Internet have changed the global context. Li and Sun (2017) argue that this has created opportunities for younger firms. They also found a positive diminishing relationship as well as a U-shaped relationship between firm age and firm performance in institutionally less developed environments. It can be

argued that as a firm ages, organisational adaptability decreases and is low because of culture and legacy structures, whereby the firm may suffer from inertia and path dependence (Guillen & Garcia-Canal, 2009).

Amighini et al. (2015) found in an analysis of OFDI in transition economies, monopolistic or oligopolistic positions of firms at home act as a catalyst to invest abroad, especially towards other emerging markets at similar stages of development. Their position in the home market enables them to take advantage of capital market imperfections, including group cross-subsidisation, which becomes an FSA and generates the resources to fuel their investments abroad (Buckley, 2018). In a later study Cuervo-Cazurra, Ciravegna, Malgarejo and Lopez (2018) found that regional internationalisation had a positive effect on firm performance.

The major insight gleaned from this study is that the most successful firms operating in emerging markets have adopted a portfolio approach to their international investment strategies. FirstRand, Standard Bank, Sanlam, Vodacom, Nedbank, Absa, Shoprite, Mr Price and Redefine Properties make up nine of the top 10 firms that created the most value over the period (excluding Naspers).

These firms share common attributes and strategies. These firms have diversified sufficiently into Africa to create a diversified geographical portfolio of investments and related operational activities. These firms have oligopolistic positions in the South African market, which has enabled them to generate the resources required for international expansion. These firms have diversified regionally. Monopolistic or oligopolistic behavior to propel them into Africa whereby they have achieved both scale and scope and can exploit their ownership advantages. These firms have retained their oligopolistic status in the markets that they have entered and are able to achieve exceptional performance due to lack of competition. These firms generate economic returns that could be classified as economic rents.

Conversely, the EMNEs that operate in emerging markets that destroyed over 80 per cent of their value have not sufficiently diversified geographically or by product differentiation. These firms mostly do not have economies of scale or scope. These firms are overly reliant on the South African market for their revenues and profits. South Africa experienced no growth over the period under review, which negatively impacted these firms' revenues and profits.

These firms include African Rainbow Minerals, ArcelorMittal, Nampak, Bidvest, Impala Platinum and Kumba Iron Ore. These firms operate predominantly in mining and

manufacturing and thus in addition to over-reliance on the home market, they are further impacted by the global business cycle. South Africa is afflicted with high levels of corruption. Countries with high levels of corruption tend to experience low levels of economic growth, which further limits their international expansion (Stoian & Mohr, 2016). Operating primarily in a market with stagnant growth will lead to sub-optimal returns and negatively affect performance. This is what is found in the study.

The major insight observed by analysing EMNEs operating in developed markets is that it can be argued that they have all specialised and have found foreign market niches and entered markets untapped by DMNEs (Luo & Tung, 2018). They have done this largely because when EMNEs go to the developed world, the number of rivals increases and competition intensifies (Deng, Yang & Van Essen, 2018). Bid Corporation has specialised in food logistics, Discovery has specialised in a health rewards programme (Vitality), Sappi and Mondi in packaging and woodfibre products respectively. Aspen specialises in specific therapeutic brands. To a degree, these too apply a portfolio approach to their international investments, such as TFG. These EMNEs are targeting big potential markets where they can compete effectively in developed markets based on product and market (geographic) specialisation.

Similarly, to their emerging market counterparts who destroyed value, EMNEs that operate in developed markets and that have failed to specialise (or diversify) sufficiently by product or geographically, have destroyed value. Consequentially, over-reliance on the home market compounded by the global business cycle has had severe consequences for these firms. Interestingly, the two consumer-facing firms (Truworths and MediClinic) have destroyed value because of poor acquisitions.

## **7.2 Practical Implications for Managers and Businesses**

Understanding whether and how to internationalise and how internationalisation affects performance based on different host country contexts is critical for managers of firms that have to craft and implement internationalisation strategies (Cuervo-Cazurra, Ciravegna, Melgarejo & Lopez, 2018).

EMNEs must understand their motives for investing abroad. Escape-based internationalisation may allow a firm to mitigate the risk of being based in an uncertain home environment with weak institutions and market constraints (stagnant growth), which are seen as comparative disadvantages. The firm may feel compelled to expand abroad to reduce its dependence on the home market for revenues and profits

(Cuervo-Cazurra et al., 2018), but it should understand its ownership advantages (FSAs and CSAs) and location specific advantages in order to select an appropriate investment location where the firms ownership advantages will enable the firm to compete effectively. Amighini et al. (2015) emphasised that EMNEs' motives for investing in developing markets are mainly for resource seeking, efficiency seeking and market seeking.

There is a reason for this. Younger EMNEs' firm-specific advantages are likelier to be more dependent on location-specific advantages because they have not had time to accumulate non-location bound FSAs. Furthermore, Cuervo-Cazurra, Ciravegna, Melgarejo and Lopez (2018) argue that firms perform better when they expand regionally into countries that tend to have similar institutional environments and are of lower psychic distance. However, investing in similar institutional environments has implications, being higher risk. Firms may mitigate institutional risk by adopting a portfolio approach to their emerging market internationalisation strategies.

Managers must be alive to the risks when investing in other emerging markets. EMNEs have a higher risk tolerance than DMNEs. Buckley et al. (2018) have noted that the international business literature has identified risk-taking as a significant competitive advantage for EMNEs over their DMNE counterparts. Investing may bring exceptional economic performance as evidenced by Vodacom, but when investing in emerging markets, risk of uncertainty and political and regulatory risk increases. Firms may also be exposed to sudden shocks, as evidenced by MTN, which was fined \$5.2 billion for non-compliance with regulation. MTN has had R143 billion in market capitalisation wiped out. The firm may be affected by factors outside its control, such as Nampak. When the price of oil dropped by half in 2014, it was overly exposed to Angola and Nigeria and was suddenly faced with a liquidity crisis.

EMNEs have the requisite FSAs, which may be non-traditional in nature, such as resilience, enabling them to compete effectively in other emerging markets with similar institutional environments. South African firms strategising to invest abroad may be better advised to invest in similar emerging markets closer to home. The financial rewards may be exceptional, but the risks increase commensurately. This would be the preferable strategy to implement compared with a developed market strategy.

Managers may perceive uncertainty as a threat (Gao, Zuzul, Jones & Khanna, 2017), and their strategic response is to escape to developed markets that are perceived as a more stable environment. Developed markets may be perceived to be a less risky

environment, as evidenced by a lack of institutional voids. These managers must understand that they may perceive the environment as less risky because it is stable, but that is illusory, because they face significant risks, just different in nature, such as rivals with superior FSAs and increased competition (Deng, Yan & Van Essen, 2018).

DMNE counterparts have more potent traditional FSAs such as cutting-edge technology and global brands (Ramamurti & Hillemann, 2018). This is because they have had more time to accumulate FSAs than their EMNE counterparts (Ramamurti, 2012).

When EMNEs invest in developed markets, the risk of organisational overstretch and business failure undoubtedly increases when they invest abroad in host countries that are naturally different from their home country (Deng, Yan & Van Essen, 2018). Compounding this is that they face high risks when making investments abroad because of their lack of necessary management knowledge, technological capabilities and internationalisation experience.

Liability of origin increases internationalisation risk. (Guillen & Garcia-Canal, 2009; Luo & Tung 2007). Managers must be aware that when investing in developed markets, the number of rivals increases and competition intensifies (Deng, Yan & Van Essen, 2018) resulting in lower returns. They need to ensure that assumptions underlying expected returns are realistic and exceed the cost of capital otherwise their investments will be value destroying. Firms would be better advised to invest in niche markets, untapped by their DMNE counterparts (Luo & Tung, 2018).

EMNEs invest abroad in developed markets to acquire strategic assets. Capital market imperfections in emerging markets, together with an oligopolistic home market position give EMNEs access to cheap money. This may lead to inadvisable and undesirable acquisitions (Buckley, 2018). EMNEs end up overpaying for their acquisitions. Perverse incentives, such as linking executive compensation to firm size and hubris exacerbate firms' appetite for foreign investments (Lebedev, Peng, Xie and Stevens, 2015). Managers must be aware of the risks associated with strategic asset seeking, especially overpaying for their acquisitions.

The study has shown that when EMNEs make general acquisitions, including Woolworths' acquisition of David Jones, or Famous Brands' acquisition of Gourmet Burger King (GBK) or the GHG acquisition by Netcare; these acquisitions generally end in failure. The ultimate failure, which demonstrates the issues of overstretch and management hubris is Sasol's Lake Charles Chemical Plant project in Louisiana, USA.



That greenfield project has incurred a US\$13 billion overrun and counting. Sasol has had half (R155 billion) of its market capitalisation destroyed, along with its reputation for competent management.

Targeted niche acquisitions have worked. The portfolio approach adopted by The Foschini Group substantiates this point. Bid Corporation, Mondi, Discovery and Investec are further excellent examples of smart, alert, agile management that has selected very specialised targeted acquisitions and investments through which to enter niche markets, untapped by DMNEs (Luo & Tung, 2018). South African firms intending to escape to a more stable environment would be better advised to select a niche acquisition strategy where DMNEs are absent, if they can be adequately identified and the right deal concluded.

To conclude on this, understanding whether to internationalise and where to internationalise has real world implications. This decision can result in the destruction of value which can adversely affect all stakeholders. Staff who worked for MTN or Sasol probably witnessed their pension funds decrease in value. Indirect investors probably witnessed the same in their investment vehicles. Destruction can have more devastating consequences such as loss of employment as evidenced by the collapse of Group 5 and Aveng.

### **7.3 Limitations of the Study**

#### **7.3.1 Unit of analysis**

The unit of analysis was the firm. The initial preferable unit of analysis was the firm subsidiary. The key reason for choosing the subsidiary as a unit of analysis is that this would have enabled the researcher to perform a more in-depth analysis of performance. This would have been particularly relevant where a South African MNE had a subsidiary in an emerging market and a subsidiary in a developed market and would have enabled the research to compare subsidiary level performance within the same firm.

The reason this was not done was that the Orbis database from which the initial selection was made, based on 2018 data, did not contain historical data. As this was a longitudinal study, the study could not be completed without historical data. As a result, the study used the firm as the unit of analysis.

### **7.3.2 Currency and related impact**

The study was completed in the reporting currency, being the South African rand. The rand as at 30 June 2013 was R9.881530/1US\$ and at 30 June 2018 it had depreciated by 39 per cent to R13.724039/1US\$.

Although the study was concerned with the economic consequences of escape FDI and it could be argued that investing abroad in a stable environment is partly to diversify the currency risk, the research was about gaining an understanding of the operating performance of the international investment. The near 40 per cent depreciation of the rand had a material impact on firm performance. This limitation links to the first limitation. The data obtained in Orbis is US dollar-based, which not only would have allowed a comparison between subsidiaries, it would have given a relative comparison excluding the impact of the currency.

### **7.3.3 Longitudinal in nature**

The study was longitudinal in nature and therefore took place at a particular point in time in terms of the global context. Commodity prices have been adversely affected by the global context, which has had a cascading effect on manufacturing and mining, and related industries. The period under review has been marked by declining commodity prices (in general), which has had negative consequences for mining and manufacturing valuations. The study only covered a five-year period (2013 to 2018) due to time constraints and data limitations. To overcome outcomes negatively affected by the downside of the business cycle, the study could have been done over a longer time period.

### **7.3.4 Motives**

The study was on the escapist motive for outbound foreign direct investment. It is based on institutional theory which assumes that because of institutional voids, underdevelopment or market constraints, a firm is “pushed” to invest abroad to limit exposure to the home country and its dependence on it for revenues and profits. In this research, it is acknowledged that a firm may invest abroad for reasons other than wanting to escape the home country institutional and market constraints. Traditional motives such as market seeking, efficiency seeking and resource seeking might well be the intention of the firm. Firms internationalisation motives may be dual in nature (Luo & Tung), being both for traditional motives (as mentioned) or escapist.

## 7.4 Suggestions for Future Research

The research has identified the unit of analysis as a limitation. Future research could do the same study but using the subsidiary as the unit of analysis, on the basis of obtaining reliable data for the period under review.

The limitation on the unit of analysis had an impact on the analysis at firm level. The operating results were affected materially by the depreciation of the rand. The study could eliminate the effect of the currency if the study was performed in US dollars, as is contained in the Orbis database.

The longitudinal study was insufficient in time horizon due to time constraints and the limitations on data collection. Future research could look at one or even two full business cycles, stretching over a 20- to 25-year time horizon. Alternatively, it could start at the beginning of our democracy in 1994, when South Africa was readmitted into the global economy. That would give a 25-year time horizon and eliminate the effects of the global business cycle to a certain extent. It can be argued that the impact of the global business cycle could not ever be truly eliminated because we live in a global world and context matters. A firm's ability to exploit resources depends upon its place in time and space (Barney, 1991). Place in time and space and thus context matters, fundamentally.

The study was only concerned with the economic consequences and did not cover the socioeconomic consequences. Future studies may want to focus on the socioeconomic consequences of the outcomes of internationalisation strategies and how they impact the wider community and related stakeholders, and not just the individual firm.

South Africa is facing a significant crisis. One only has to listen to the daily news to gain an understanding of the predicament the country faces. The lack of growth is driving companies out of South Africa in search of growth. Addressing job creation and inequality are fundamental if South Africa is to move forward and enjoy a prosperous future. Future research should focus on the regulations that are constraining companies and forcing them to invest abroad. An understanding could assist policymakers to craft the right type of regulations to create confidence, which will trigger investment and slowly get the economy working. We need real GDP growth of four per cent to five per cent to start to impact unemployment and address both the unemployment and inequality crises that South Africa evinces.

Future research should focus on current regulation, particularly protectionism (such as the Broad-Based Black Economic Empowerment Act) and the impact that protectionism is having on private firms' competitiveness. It has been established in the literature that countries characterised by weak institutions, including South Africa, suffer from a lack of competitiveness because weak institutions push up the cost of doing business (Cuervo-Cazurra, Ciravegna, Melgarejo & Lopez, 2018).

Managers devise strategy and take decisions. This resonates with institutional theorists who maintain that institutions not only include formal laws and regulations, but also include informal rules and norms, specifically the preconscious cognitive and ideational elements that are embedded in culture and are widely accepted by society (Ahlstrom et al., 2014). Therefore, culture, including firm culture, has an enormous impact on investment decisions. Future research could focus on the cognitive and ideational elements of international investment decisions and the underlying root causes and drivers. In this study, it is acknowledged that how to go about doing this research would be extremely difficult because it could be argued that decision-makers may not be truthful in their answers, especially if the investments have been failures.

## **7.5 Conclusion**

Escape FDI is a complex subject, which is particularly relevant to South Africa in the context of the current political, social and economic environment. It is going to attract more scholarly attention as the emerging market world contributes increasingly to global GDP and global investment. If South Africa continues on its current path, escape-based FDI will likely intensify.

This study was very clear about how home country institutional conditions and market constraints are pushing firms to go abroad. This trend has to stop, or the consequences will go beyond the economic effects. This was pinpointed by Pioneer Foods commentary around Land Reform. Uncertainty may negatively affect productivity, which may lead to unemployment and hardship. This can create a death spiral where diminished productivity is replaced with imports, pushing up unemployment and pushing up the price of food. This further reduces investment and productivity and so forth. This affects the poor the most. This could have devastating political and social consequences. The economic consequences really do matter.

South Africa is facing an economic crisis. It needs to start growing and creating opportunities for big business as well as entrepreneurs in order to address the

unemployment crisis. The country is on a knife-edge. Escape FDI is a direct response to the political instability and uncertainty and volatility that is exhibited in the current regulatory environment. A stagnant economy is exacerbating the phenomenon.

Firms that cannot grow in a stagnant economy are going to escape in search of growth, whether to the emerging world or to the developed world. Weak governance, weak institutions, corruption and poorly conceived and executed regulation are making managers nervous. Thus, the firm feels the need to “safeguard” itself against these risks and the need arises for a “spare business” (Barnard & Luiz, 2018). The push factor is a desire to escape the environment and move to safer havens, which can lead to capital flight, whereby the firm is simply used as camouflage for the international transfer of wealth (Buckley, 2018). As the fiscal situation in South Africa deteriorates, this phenomenon is going to increase. South Africa is at a cross-roads. Escape FDI is one manifestation of the complexities, challenges and issues that face the country. The saddest part is that escape FDI is not on the national agenda despite its enormity, significance and consequences, both economic and social.

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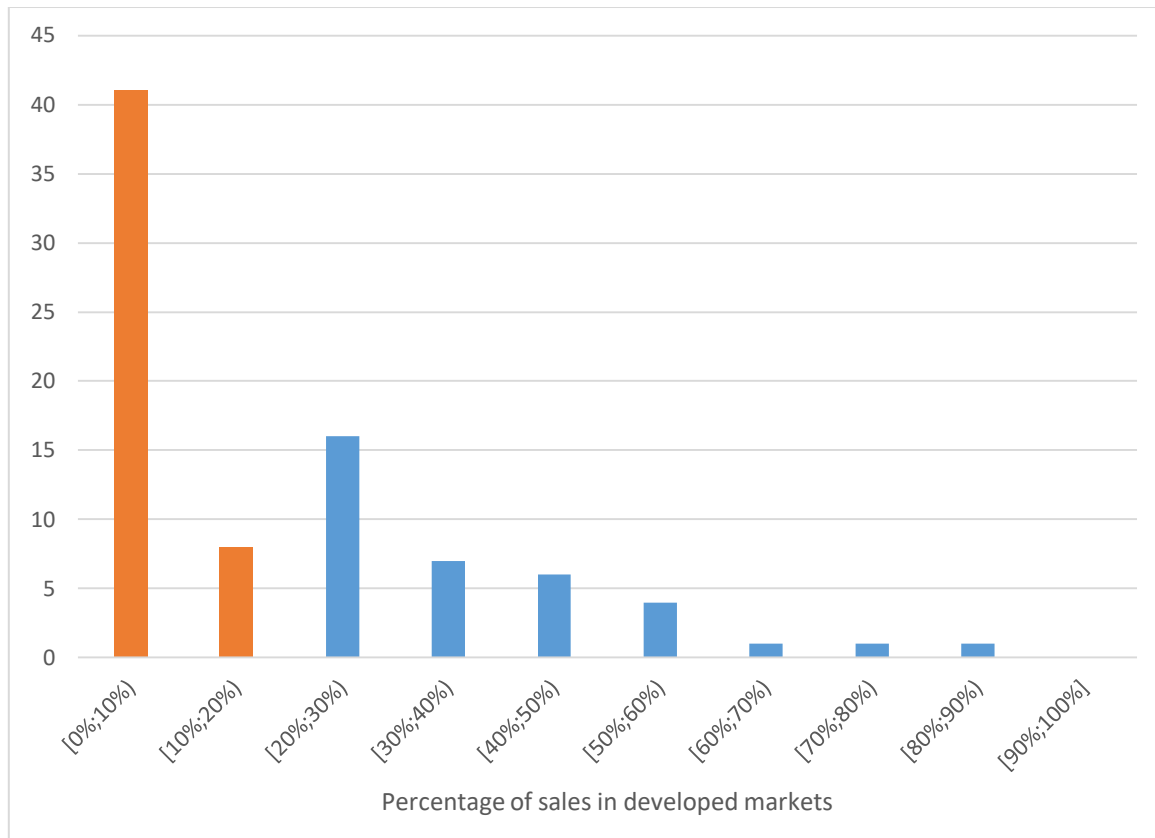
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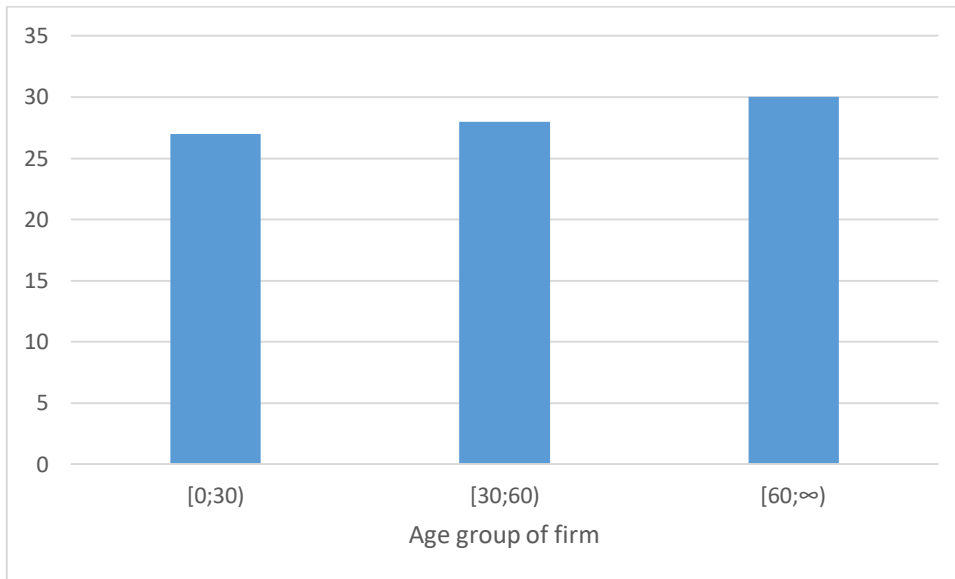
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## Appendix 1: Distribution of Firms by % Sales or Assets in Developed Markets



Source: Author own

## Appendix 2: Distribution of Firm Age



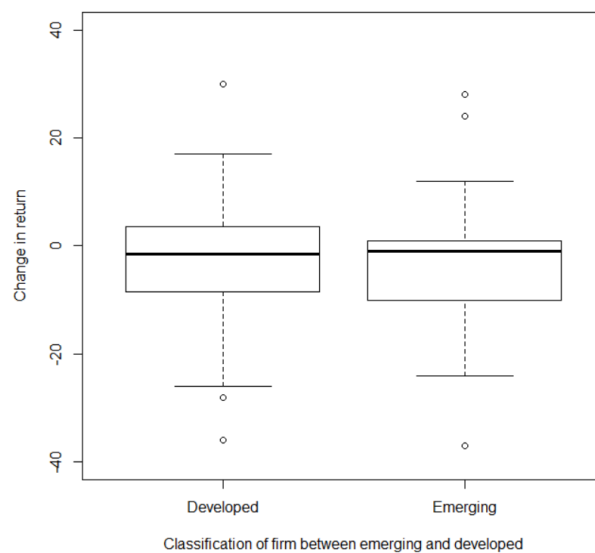
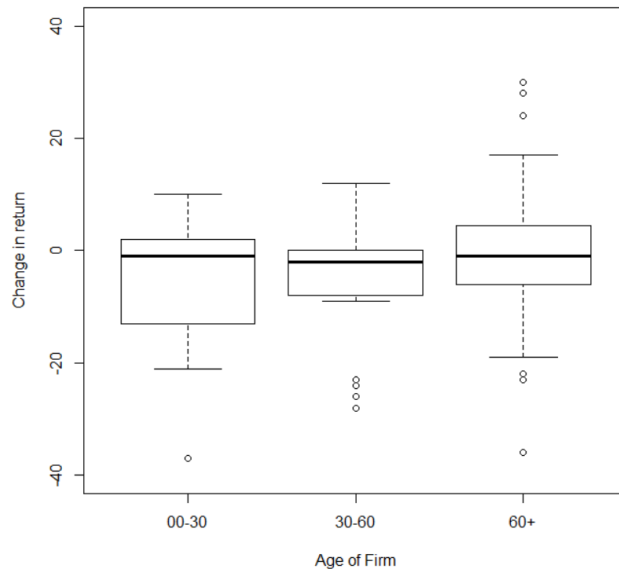
Source: Author own

## Appendix 3: Spread of Observations

A box plot for each of the five dependent variables is depicted below with commentary.

### a) Return on Assets

#### Box Plot of Return on Assets



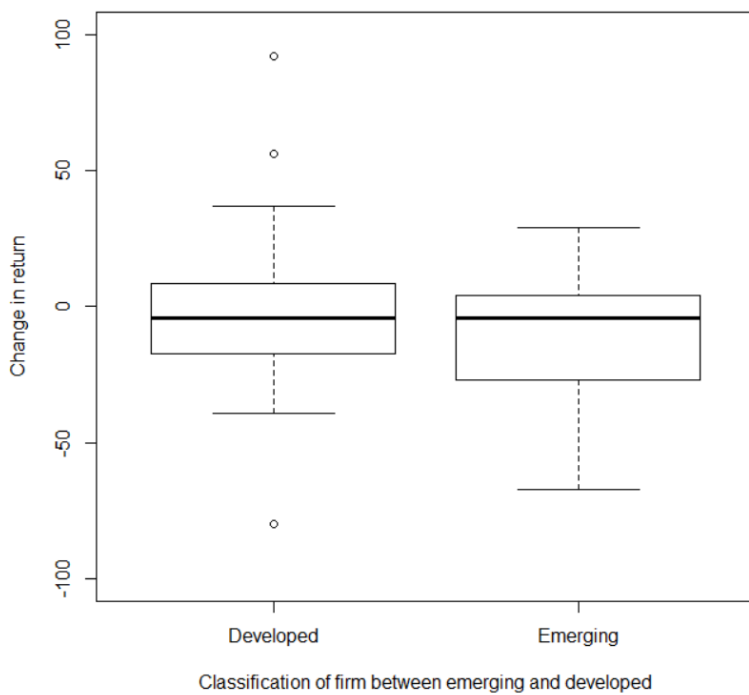
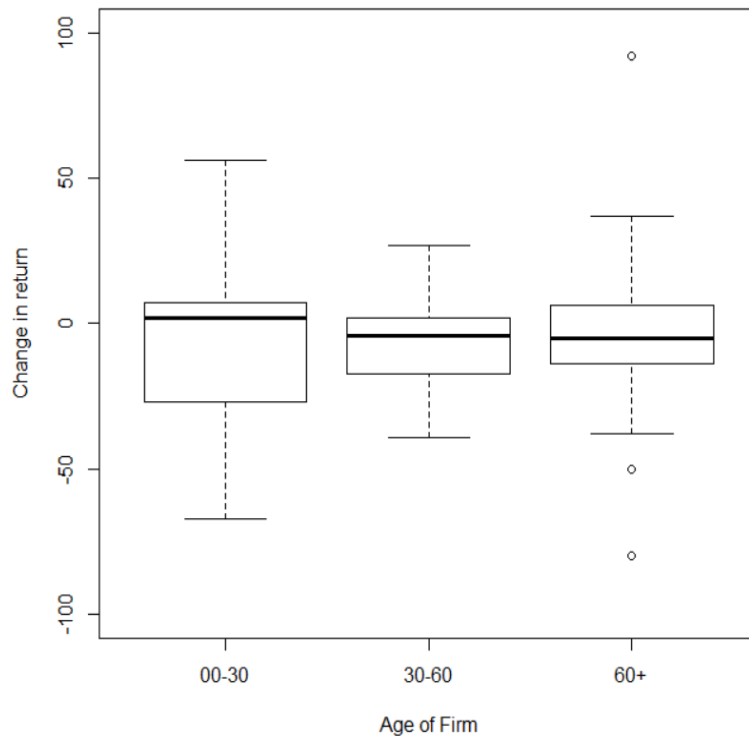
When considering firms younger than 30 years, the observations are widely spread around the median. Firms older than 30 years have a smaller spread around the median. These firms also have a larger number of outliers.



Firms investing only in emerging markets are clustered around the median, with some outliers identified. Firms investing in developed markets have a similar number of outliers to emerging market firms.

b) Return on Shareholders' Funds

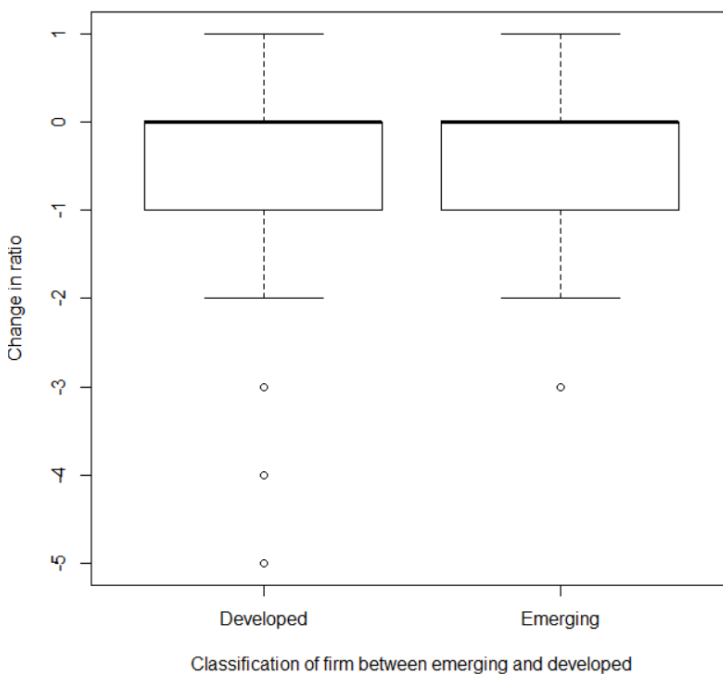
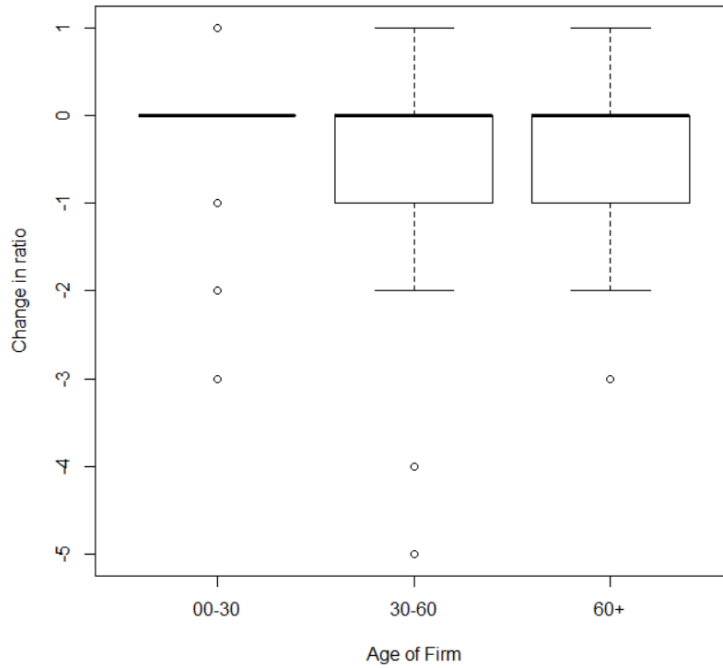
**Box Plot of Return on Shareholders' Funds**



Firms investing in emerging markets and developed markets are clustered around the median, with some outliers identified.

c) Tobin's Q

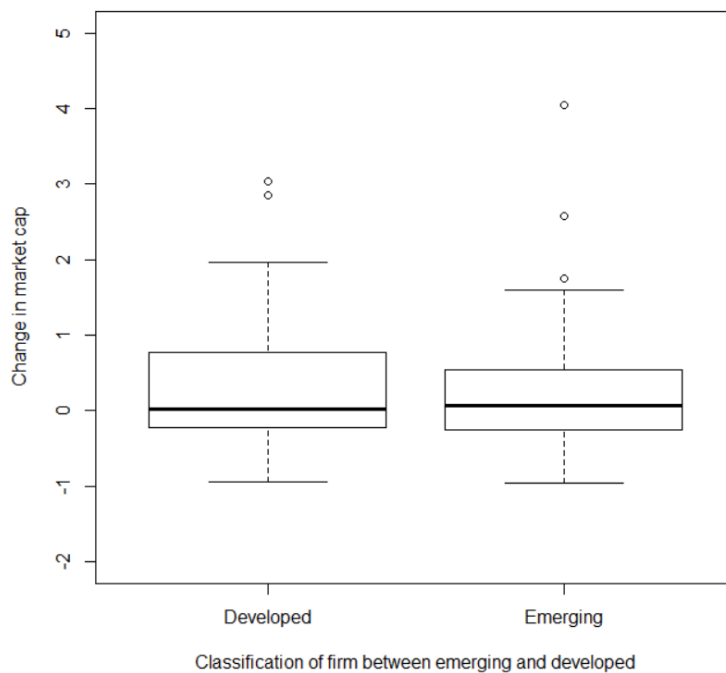
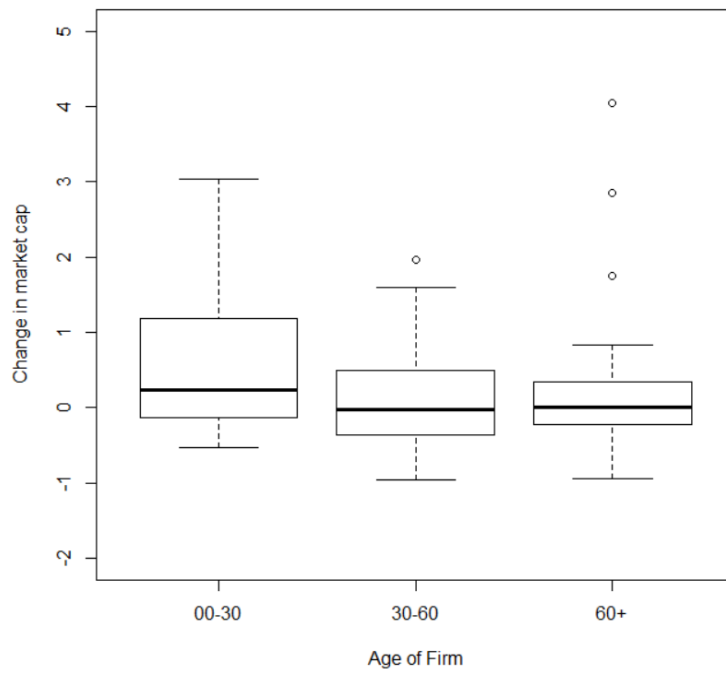
**Box Plot of Return on Tobin's Q**



When considering the spread in change in Tobin's Q, note that in both graphs there are a number of outliers towards the bottom of the plots. This indicates that the distribution is skewed with a long tail of observations.

d) Market Capitalisation

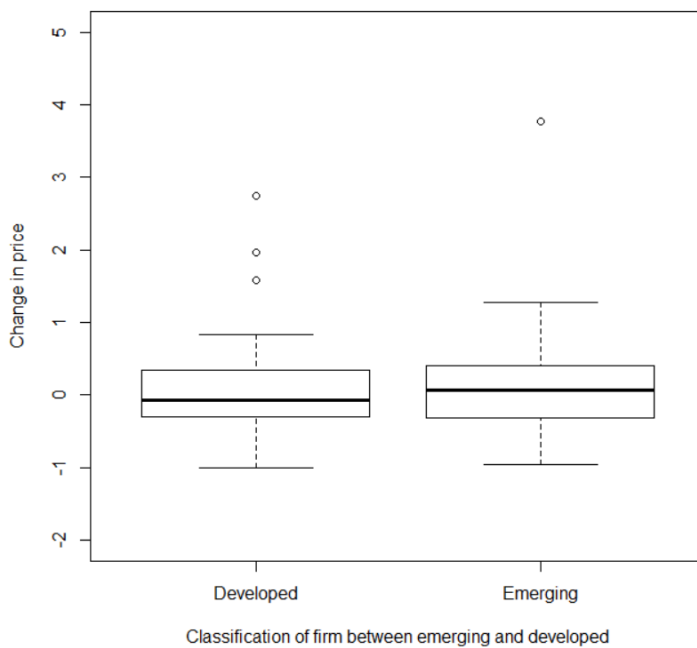
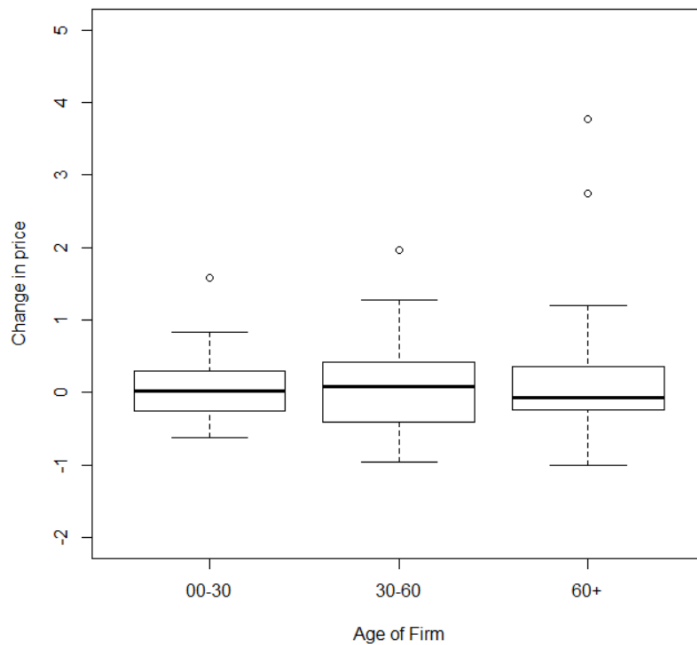
**Box Plot of Return on Market Capitalisation**



Outliers in change in market capitalisation are found to be at the top of the box plots. This indicates outlier firms with significant increases in market capitalisation between 2013 and 2018. In each of the plots, the median observation indicates that the data is skewed.

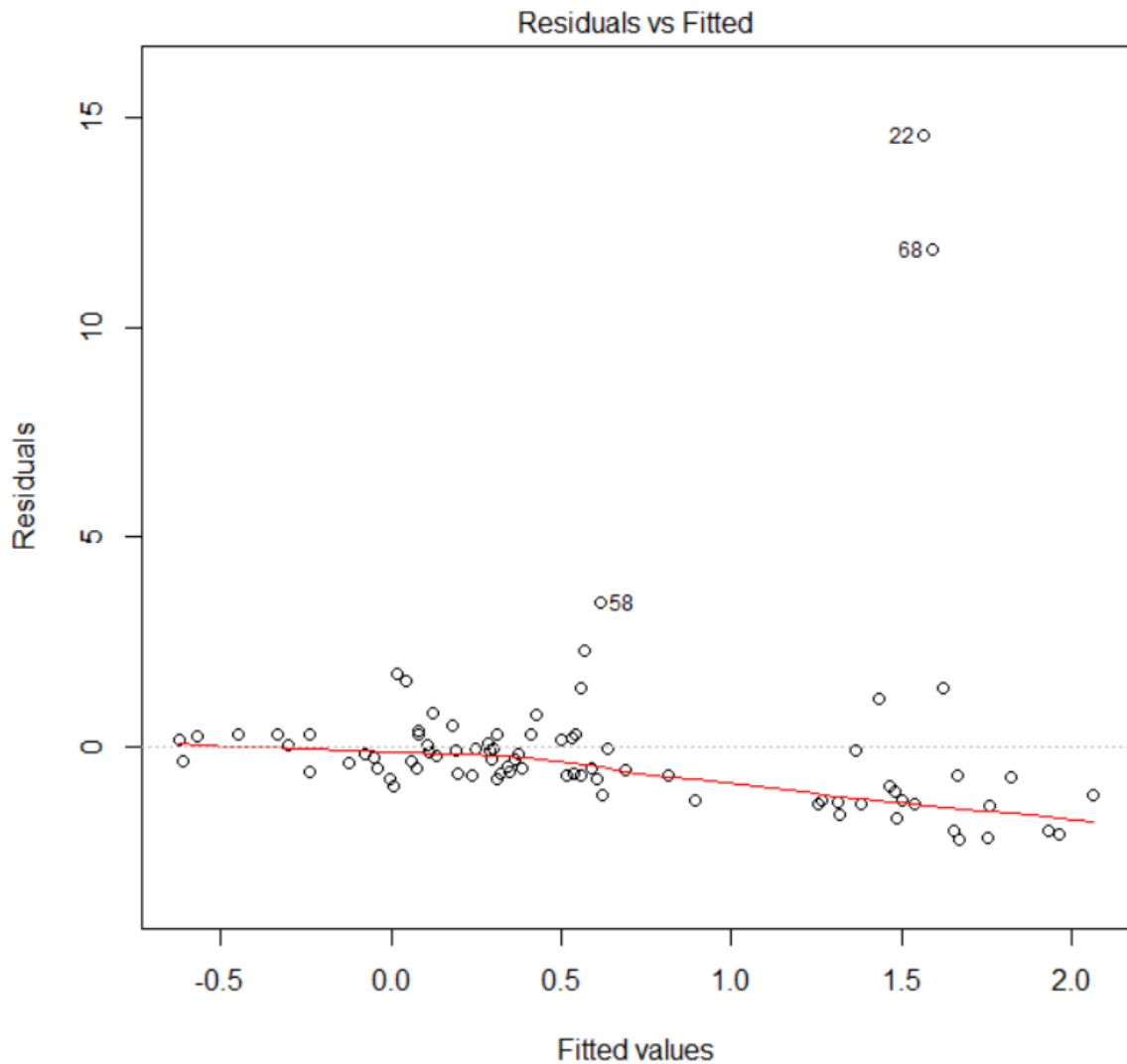
e) Share Price

## Box Plot of Return on Share Price



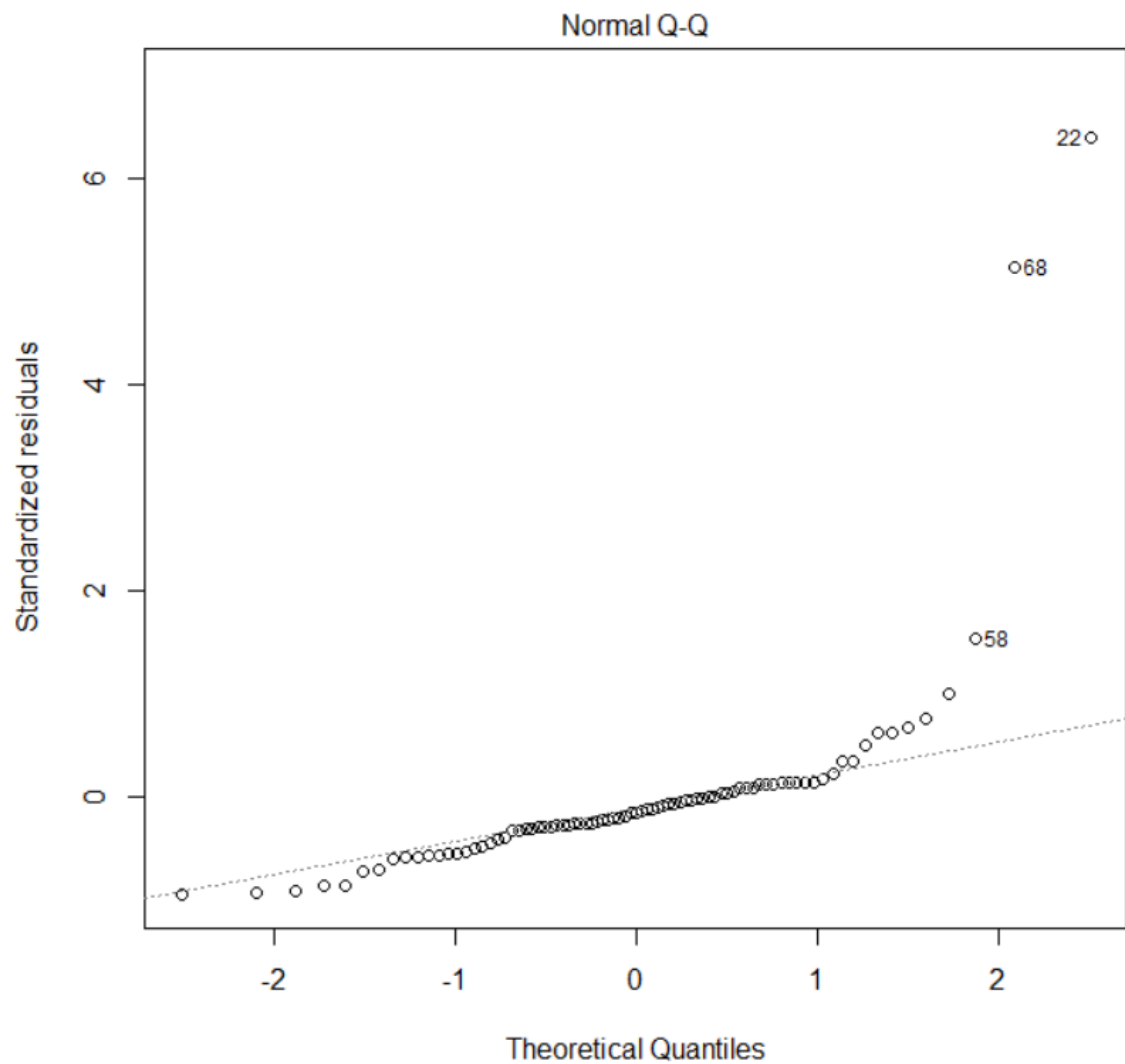
Similar to market capitalisation, a large number of outliers can be observed towards the top of the plots. This indicates outlier firms with significant increases in share prices between 2013 and 2018.

## Appendix 4: Residuals vs Fitted Observations Excluding Outliers



Observations 22 and 68 are ENX Group Limited and Redefine Properties Limited respectively. These observations are shown to differ significantly from the model expectation.

## Appendix 5: Normal Q-Q Plot Excluding Outliers



22 – ENX Group Limited

58 – Naspers Limited

68 – Redefine Properties Limited

Appendix 4 and 5 included to compare the residuals to the market expectations and that the data conforms to a normal distribution. The model is considered a good fit for the data.