

Perceived Maturity of Institutions in Emerging Economies and Corporate Knowledge Transfer

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ABSTRACT

This paper examines the effect of perceived maturity of institutions in emerging economies on the knowledge transfer process within multinational companies (MNCs). Based on North's (1990) institutional framework and Peng's (2003) two-phase model of institutional transitions, I introduce the concept of maturity of institutions and examine the impact of subsidiary managers' perception of institutional maturity on corporate knowledge transfer. Motivation to seek knowledge, search costs, and transfer costs, (adapted from the three-stage model of organizational knowledge sharing by Hansen, Mors, & Lovas, 2005), will be considered as outcomes of perceived maturity of institutions. Following literature review and hypothesis development, methodology section discusses in detail measures for variables and prospective sample and data collection techniques from MNCs' subsidiaries in computer industry in Vietnam. Discussion, limitations, and implications for theory development and practices will be provided.

INTRODUCTION

Knowledge transfer in the multinational company (MNC) is a phenomenon which has attracted much attention of organizational researchers (e.g., Duanmu & Fai, 2007; Gupta & Govindarajan, 2000). From the resource-based view, the phenomenon is interesting and substantive as knowledge can be considered as a strategically important asset of the firm (Barney, 1991), and knowledge transfer contributes to the competitive advantage of the firm (Argote & Ingram, 2000). Indeed, a fundamental assumption of a knowledge-based theory of the firm is that knowledge is a critical input and primary source of value and a firm can be conceptualized as a knowledge-integrating institution (Grant, 1996).

Although there has been a great number of studies on knowledge transfer within MNCs across developed countries (e.g. Dyer & Nobeoka, 2000; Dyer & Hatch, 2006; Hansen, 1999), there have been much less studies on corporate knowledge transfer practices into or out of emerging economies. An emerging economy is characterized by the rapid pace of economic development and the institutional transition toward a market-oriented economic system (Arnold

& Quelch, 1998). Moreover, institutional changes in emerging countries are remarkable in magnitude and pervasive in scope (Hoskisson, Eden, Lau, & Wright, 2000; Peng, 2003). Some researchers have called for more attention to the effect of emerging/developing country context on MNC behavior and the co-evolution of these two variables over time (e.g., Meyer, 2004; Ramamurti, 2004).

The purpose of this paper is to examine how institutional transitions in emerging economies affect corporate knowledge transfer in MNCs. Based on North's (1990) institutional framework and Peng's (2003) two-phase model of institutional transitions, I introduce the concept of maturity of institutions that refers to the degree to which institutional context of an emerging economy is evolving from the early phase toward the late phase (in words of Peng, 2003). This construct is measured by a summated rating scale of perception of managers of MNCs' subsidiaries in computer industry in Vietnam and serves as the independent variable in explaining corporate knowledge transfer. Adapting Hansen, Mors, and Lovas' (2005) three-phase model of organizational knowledge sharing process and taking a nodal perspective of a subsidiary, I will operationalize three following variables as dependent variables in this study: motivation of managers of a subsidiary to seek knowledge from headquarters and/or other subunits of the MNC, search costs, and transfer costs. Thus, the direct research question of the current paper is: how perceived maturity of institutions in emerging economies affects subsidiary managers' motivation to seek outside knowledge from other parts of the MNC, search costs, and transfer costs.

Excluded from the focus of this paper are the knowledge transfer practices taken place in different contexts such as inter-firm knowledge transfer in a supply chain (e.g., Crone & Roper, 2001; Dyer & Hatch, 2006) or knowledge transfer between strategic alliance partners (e.g., Simonin, 1999). Further, a subsidiary can be a wholly owned division of an MNC or a joint venture with local partner(s); I do not distinguish these two subsidiary forms in this paper.

Vietnam has been recognized as an emerging economy. Vietnamese economy is characterized with significant changes in institutions during the socio-economic transformation from centrally planning to market-oriented systems (Chand, Duncan, & Quang, 2001; Han & Baumgarte, 2000; Meyer, Tran, & Nguyen, 2006). The economy has maintained high economic growth over the last fifteen years, average 7.3% annually during 1990s (Statistics Publishing House of Vietnam, 2004). Furthermore, Vietnam has also been recognized as one of the most attractive destinations in Southeast Asia for foreign direct investments (FDIs). For example, the country ranked first as top location for manufacturing opportunities in the PricewaterhouseCoopers' 2007 EM20 index for twenty key emerging markets.¹ Vietnam is also a highly potential market for services such as retailing. A.T. Kearney, a global strategic management consulting firm having offices in 33 countries, reported Vietnam in the fourth place (after India, Russia, and China) in its 2007 global retail development index.² The fascinating developments of Vietnam encourage me to choose the economy as context for this research.

The computer industry represents rapid paces of technological innovation, changing customer demands, relatively short product life cycles and significant product differentiations (Henderson, Miller, & Hambrick, 2006). With such industrial dynamisms, companies in computer industry must be very active in knowledge creation and knowledge transfer in order to maintain their competitiveness.

A multilevel study, this paper contributes to literatures of institutional theory and corporate knowledge transfer in MNCs. It goes beyond merely integrating the two models Peng (2003) and Hansen et al. (2005) by: (1) operationalizing two phases of institutional transitions as

a continuous variable of institutional maturity; (2) using a continuous variable of motivation to seek outside knowledge, rather than the dichotomous 'yes or no' variable of deciding to seek knowledge as suggested by Hansen and his colleagues, as an outcome variable; and (3) using multi-item measures for all variables in the model. In addition, the present research provides strategic implications for MNCs to overcome knowledge transfer hurdles generated by institutions in emerging economies.

The rest of the paper is structured as follows. Next section is devoted to the review of literatures of corporate knowledge transfer and the institutional transition in emerging economies; hypotheses will be developed. The methodology section explains measurement issues and tentative sample and data collection techniques. Discussion, limitations, theoretical and practical implications will then be provided.

THEORETICAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

Knowledge transfer in the context of the MNC

The present paper adopts Gupta and Govindarajan's (1991) definition of intracorporate knowledge flow as the transfer of expertise of all types (from input, throughput, to output processes) and/or external market information (e.g., information about key customers, suppliers, or competitors) within the context of the MNC. Excluded from the scope of knowledge transfer is the transfer of internal administrative information (e.g., periodic financial data). Furthermore, in this study knowledge transfer, knowledge sharing, and knowledge flow are used interchangeably.

From network perspective, studies on knowledge transfer can be conducted at various levels of analysis. Gupta and Govindarajan (2000) argue that flows of knowledge through the intraorganizational network can be investigated from at least three different levels of analysis: nodal, dyadic, and systemic. At the nodal level, the researcher focuses on the characteristics or behavior of individual units, either the source or the recipient of knowledge. These two authors, taking the nodal level of analysis, conceptualize knowledge flows within MNCs as a function of five factors: (i) value of the source unit's knowledge stock, (ii) motivational disposition of the source unit, (iii) existence and richness of transmission channels, (iv) motivational disposition of the target unit, and (v) absorptive capacity of the target unit. The current study takes the nodal perspective of a focal subsidiary in order to investigate the effects of perceived maturity of national institutions in emerging economies on the motivation to seek knowledge from other parts of the MNC, search costs and transfer costs.

At the dyadic level of analysis, the joint behavior and possible reciprocal relationships between unit pairs will be the central research theme. For example, Hansen (1999), adopting the concept of weak ties from social network research, examines the role of weak interunit ties in knowledge sharing among divisions within a multiunit organization. He finds that weak ties help new product development project teams search for useful knowledge in other divisions but impede the transfer of complex knowledge, which requires a strong tie between the two parties under the transaction.

At the systemic level of analysis, however, the behavior of the entire network will be focused. Reagans and McEvily (2003), for instance, collect data from a contract R&D firm and show that both social cohesion and network range are positively associated with the ease of knowledge transfer. Systematic approach is most suitable for simultaneously studying dynamic relationships among subunits within MNCs in the knowledge transfer process.

From another stream of research on knowledge transfer, a processual approach, Szulanski (1996) views the intra-firm transfer of best practice as a four-stage process. The initiation stage includes all events or activities leading to the decision to knowledge transfer. During the implementation stage, resources and knowledge flow between the source and the recipient. Next, the ramp-up stage begins when the recipient starts using the transferred knowledge. Finally, the integration stage begins after the recipient successfully uses the transferred knowledge to achieve satisfactory results. In this stage, the use of the transferred knowledge becomes routinized. In each of the stages, there are hurdles that the two partners must overcome to make the transfer possible. Consequently, Szulanski advocates strong relationships between the recipient and the source of knowledge.

From the same process perspective, Hansen, Mors, and Lovas (2005) propose a three-stage model of knowledge sharing process: (i) deciding whether to seek knowledge from other subsidiaries, (2) search costs, and (3) transfer costs. The present study adapts this three-stage model to introduce three outcome variables of maturity of institutions in emerging economies: motivation of subsidiary managers to seek knowledge from the rest of the MNC, search costs, and transfer costs. The reason for modifying the original element in Hansen and his colleagues' (2005) model into motivation to seek outside knowledge is that the latter can be treated as a continuous variable rather than dichotomous 'yes or no' decision to seek knowledge. Furthermore, while the latter two elements in Hansen and colleagues' (2005) model were measured by single-item measure, the present paper measures them using multiple items. More details on measurement issues will be given in methodology section.

Institutional transitions in emerging economies

Institutions refer to "rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction." (North, 1990, p. 3) In his 1990 seminal book, North developed an institutional framework that contains formal constraints (e.g., laws), informal constraints (e.g., customs and norms), and enforcement mechanisms. It is common that institutions evolve gradually over time rather than change radically and suddenly.

Another well-known framework of institutions at national level is one proposed by Scott (2001). This author introduces three pillars of institutions: (a) regulatory pillar refers to explicit regulatory processes (e.g., rule-setting activities), (b) normative pillar emphasizes normative rules which include values and norms of the society, and (c) cultural-cognitive pillar reflects taken-for-granted shared understanding of social actors. While Scott's framework is more sociological, North's is more economic. The present paper adopts North's approach to institutional domain.

An emerging economy can be defined as the economy with two key criteria: (a) a rapid pace of economic development (e.g., fast economic growth rates) and (b) the adoption of economic liberalization policies favoring free market orientation (Arnold & Quelch, 1998). Emerging economies may include transition economies which are in the transition from their former command and centrally planning systems to the free market systems (Arnold & Quelch, 1998; Hoskisson et al, 2000). Peng (2003) asserts that transition economies are formerly socialist countries which are currently transforming toward the free market system. Those economies typically include formerly command economies in East Asia (e.g., China and Vietnam), Central and Eastern Europe and the newly independent states of the former Soviet Union. As transition economies usually share the two key criteria (mentioned above) of emerging economies, they can be deemed as a subset of emerging economies (Hoskisson et al, 2000; Peng, 2003).

Accordingly, the current research considers transition economies as a type of emerging economies.

Emerging economies experience noticeable and extensive changes in all aspects of institutions (Hoskisson et al., 2000; Peng, 2003). Peng (2003) proposes a two-phase model of institutional transitions in emerging economies. The first phase (also called the early phase), featuring with lack of formal institutions, typically contains personalized and relationship-based transaction structures. On the other hand, the second phase (or late phase), with the existence of more formal institutions, typically includes impersonal and rule-based transaction structures. Peng argues that firms' strategic choices vary in accordance with the evolution of the economy through these two phases of institutional transitions.

Based on North's (1990) institutional framework and Peng's (2003) two-phase model of institutional transitions, I introduce the concept of *maturity of institutions* which refers to the degree to which institutional context (i.e., formal constraints, informal constraints, and enforcement systems) of an emerging economy is evolving from the early phase toward the late phase (in words of Peng, 2003). Thus, an institutional context is considered being more mature when it is more characterized with formal, impersonal, rule-based transaction structures. On the other hand, an institutional context is deemed being less mature when it is typically featured with informal, personal, and relationship-based transaction structures.

Knowledge transfer in emerging economies

Emerging economies are characterized by the lack of formal institutions, the dependence on network- or relationship-based structures, and the massive changes in institutional foundations (Hoskisson et al., 2000; Peng, 2003). Institutional transition practices in emerging economies are so idiosyncratic, especially in the initial phase of the transition, because of pervasive changes in institutional foundations and the way each economy conduct those changes (Hoskisson et al., 2000; Peng, 2003). Michailova and Hutchings (2006), for example, highlight differences in the institution transformation in China and Russia. While China has adopted an incremental approach with the overall control of central authorities so that a hybrid model that allows the coexistence of plan and market can be gradually developed, Russia took a radical change in 1992 which destructed the centralized planning system and went for new market institutions.

Like Bennett, Bouma, and Ciccozzi (2004), who contend that effective transfer of education and knowledge across countries with different economic and cultural contexts requires recognition of their institutional frameworks, in this study I argue that institutional transitions in emerging countries have effects on all three elements of the knowledge transfer process within MNCs (Hansen et al., 2005). More specifically, in the early phase of institutional transitions (Peng, 2003) business activities of a subsidiary in an emerging economy may be influenced remarkably by the idiosyncratic institutional status of the host country and, therefore, managers of the focal subsidiary may have lower degrees of motivation to seek knowledge from other subunits of the MNC. However, when the economy moves forward in the institutional transition process (i.e., the institutions are more mature) and, thus, more formal institutions are established, the managers are more motivated to look for outside knowledge from other parts of the MNC. Consequently, I hypothesize:

Hypothesis 1. The maturity of the institutions in the host country is positively correlated with the motivation of subsidiary managers to seek knowledge from other parts of the MNC.

According to Hansen et al. (2005), when the decision of seeking for new knowledge has been made, search costs occur due to activities of looking for, indentifying, and evaluating specific knowledge to be transferred and its residence. High idiosyncrasy in the institutional context of an emerging economy, especially in the early phase of institutional transitions, will lead to higher costs of searching for knowledge. Thus, I propose:

Hypothesis 2. The maturity of institutions in the host country is negatively correlated with search costs for knowledge within MNC incurred by the subsidiary.

Once a subsidiary has identified knowledge it needs, the knowledge should be transferred from the knowledge provider to the subsidiary. This process involves in modifying, editing, and incorporating the transferred knowledge into the business practices of the recipient who incurs transfer costs. The transfer costs may be higher in the earlier stage of institutional transitions because the subsidiary is highly dependent on in-network members in the host country and feels uncertain or lack of trust in out-network partners (Granovetter, 1985). Therefore, I propose:

Hypothesis 3. The maturity of institutions in the host country is negatively correlated with the transfer costs incurred by the subsidiary.

Figure 1 summarizes the relationships hypothesized for empirical testing. The figure shows two points worth noticing: (a) for the sake of simplicity the current study treats three elements of knowledge transfer process (Hansen et al., 2005) as three separate dependent variables, ignoring the linkages among them in the process, and (b) the perceived maturity of institutions plays a role of continuous independent variable.

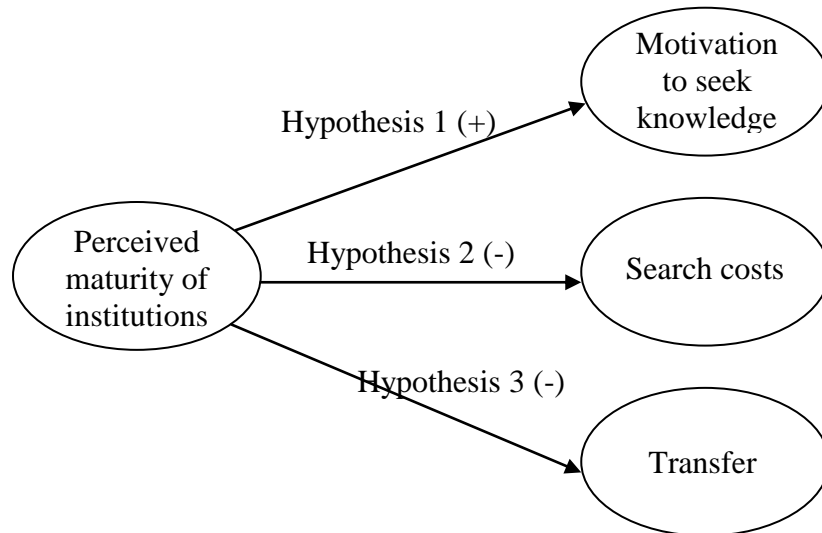


Figure 1: Hypothesized relationships between independent and dependent variables

METHODS

Sample

This paper, from a nodal perspective of a subsidiary in an emerging economy, examines the effect of the host country's maturity of institutions on knowledge transfer within MNCs. Therefore, the sample must only contain subsidiaries which are currently doing business in

emerging economies. For the purpose of the present study, it is not necessary to distinguish whether headquarters of the MNC reside in developed or developing/emerging economies.

Accessing business directories published by the Ministry of Planning and Investment, the governmental agency responsible for administering foreign direct investments in Vietnam, I randomly identify 300 business organizations which are subsidiaries of foreign parent companies in computer industry. Survey questionnaires were mailed to the subsidiary's managers. The questionnaire was written in English only as it is assumed that the managers must use English effectively in the international business environment.

As not every subsidiary has entered in all three stages of knowledge transfer process (i.e., motivation to seek knowledge, search costs, and transfer costs), the questionnaire includes the question: which of the following stages of knowledge transfer process has your subsidiary engaged in (you can check more than one if applicable)? Therefore, we have different samples for testing different hypotheses.

Measures

The first dependent variable is the *Motivation to seek knowledge*. Unlike Hansen and his colleagues (2005), I do not ask CEOs whether or not they decide to seek outside knowledge from the rest of the MNC. Instead, I ask them to show their motivation to seek different types of knowledge on seven-point Likert-type scales ("strongly unmotivated", 1 to "strongly motivated", 7). Referring back to the definition of knowledge transfer adopted from Gupta and Govindarajan (1991), I ask respondents to show how high are their motivations to seek knowledge of inputs, throughputs, outputs, and external market information (e.g., key customers, suppliers, and competitors) from other parts of their MNC.

Search costs is the second dependent variable. Hansen et al (2005) suggests that time spent looking for, identifying, and evaluating knowledge from other subunits of the MNC may be the most salient indicator for search costs. I ask the CEOs: How long has your subsidiary spent on looking for, or identifying, or evaluating knowledge from other parts of the MNC? The *search costs* variable is measured by the absolute number of months spent on search.

The third and final variable is *transfer costs*, which are due to activities such as modifying, editing, and incorporating knowledge transferred. Based on the instrument proposed by Hansen and his associates (2005), I ask: How long has your subsidiary spent on modifying, or editing, or incorporating the knowledge transferred? Again, the time here is measured by the number of months the subsidiary has spent doing such activities.

The sole independent variable in this study is the *maturity of institutions* in the emerging economy. Based on Peng's (2003) explanations of the two phases in the model of institutional transitions, this paper measures the perceived maturity of institutions in an emerging economy as the extent to which the subsidiary managers perceive the host country's institutional system is formal, impersonal, and rule-based system. In other words, the more formal, impersonal, and rule-based the institutional system, the more mature institutional system is. The questionnaire includes such an item as "In your opinion, business laws and regulations in this economy are stated very clear". Respondents are asked to indicate how strongly they agree or disagree with such a statement on a seven-point Likert-type scale (i.e., "strongly disagree", 1 to "strongly agree", 7). A respondent's scores on each item were summated to obtain the individual's summated score of perceived maturity of institutions.

I believe that age of a subsidiary may affect its motivation, search costs, and transfer costs for knowledge from other subunits of the MNC. The reason is that age may have effects on

liabilities of foreignness of the subsidiary and the associated costs incurred (e.g., Luo, Shenkar, & Nyaw, 2002; Zaheer, 1995). Thus, we control for subsidiary age. Another control variable is the size of the MNC. As the bigger MNC (measured by the number of its division and subunits) may lead to higher search costs for knowledge, we also control for the size of the MNC.

Three regression analyses will be run separately to test the hypotheses. In each analysis, control variables are first entered in the model, then the independent variable which is the perceived maturity of institutions.

DISCUSSION AND IMPLICATIONS FOR FUTURE RESEARCH

The current paper examines the effects of institutional transitions in emerging economies on the process of knowledge transfer within the MNC. Essentially, the two-phase model of institutional transitions (Peng, 2003) and the three-stage model of knowledge transfer (Hansen et al 2005) are integrated in order to develop hypotheses.

This research contributes to literatures of institutional theory and knowledge transfer within MNCs by strengthening the relevance of institution theory in research in the context of emerging economies, where institutional changes are extensive in scope and remarkable in magnitude (Hoskisson et al, 2000). Assuming all the hypotheses are supported, the findings are in line with suggestions in knowledge transfer literature that the context matters (Szulanski, 1996).

The current study has some limitations which should be pointed out. First, it bases on the nodal view of knowledge transfer. More specifically, it examines the subject matter from the view of a subsidiary in an emerging economy, ignoring possible relationships between the subsidiary and the rest of the MNC network. Furthermore, I examine only inflow knowledge from outside into a subsidiary in an emerging market. This brings opportunities for further research in which researchers can also take into account outflow of knowledge. Another limitation is that stages of knowledge transfer process were treated as separate elements, ignoring possible linkages among them in the process. This raises fruitful opportunities for future research using structural equation modeling techniques.

This paper has important implications for research. First, it offers opportunities for empirical testing the proposed hypotheses. Operationalizing two phases of institutional transitions (Peng, 2003) into maturity of institutions is a way to approach empirical testing. Future research may focus on measurement issues of this construct or develop new constructs to represent institutional transitions in emerging economies. Second, the integration of knowledge transfer theories and institution theory in the context of emerging economies is highly potential for future research (e.g., Bennett et al, 2004; Hoskisson et al, 2000). Future research may employ longitudinal design as time dimension is inherently embedded in the both models Hansen et al. (2005) and Peng (2003). Third, replications of the present study in various industries are welcome.

The present research has implications for practitioners as well. Understanding the effects of institutions on the knowledge transfer process helps MNCs develop appropriate multinational strategies, including both entry and business strategies, in emerging economies. The MNC may let its subsidiaries be more embedded into the local network in case the institutions in the host country are more mature; or it may actively work to change the local institutional environment so that institutional system facilitates rather than impede corporate knowledge transfer. The MNC may even stay away from a specific market because of the immaturity of institutional

foundations in the host country (Khanna, Palepu, & Sinha, 2005). Furthermore, facing institutional hurdles in an emerging economy, MNC headquarters may have to work proactively to make their subsidiaries aware of potential knowledge sources from other parts of the company. Doing so, they can reduce the cost of searching and integrating new knowledge into their subsidiaries.

The present study has suggestions for governments of emerging economies. Governments should speed up their institutional transformation toward the market-oriented system so that their institutions facilitate corporate knowledge transfer. The slower the pace of institutional transitions in emerging countries, the higher the hurdles for knowledge transfer within MNCs into and/or out of those countries.

NOTES

1. Vietnam is top destination for manufacturing opportunities (September, 2007). *Financial Director*, p. 51.
2. *Growth opportunities for global retailers: The A.T. Kearney 2007 Global Retail Development Index* (2007). A.T. Kearney, Inc.

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