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Relational capital from foreign partners as source of value creation: the mediation role of companies' dynamic capabilities

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Several stylized facts about FDI in transition/developing countries

- The half of largest FDI recipients are developing countries (UNCTAD, 2016)
- Since 2012 – for the first time ever – emerging economies absorbed more FDI than developed countries, accounting for 52 per cent of global FDI flows (UNCTAD, 2016)
- If in developed countries FDI inflows fell dramatically during 2008-2015, transition economies have seen a relatively small decline during the same period and reach a new high of $765 billion in 2015 (UNCTAD, 2016).
- Companies with foreign ownership in Russia continuously increased over the past 10 years and equalled more than 23,000 at the end of 2016, twice as many as in 2004. (Rosstat,2016)

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The idea of the paper came from….

- ***The importance of FDI*** towards the firm growth through (apart form loosing financial constraints)
  - human capital formation support,
  - knowledge transfer,
  - adoption of modern and sophisticated technologies from the parent company to its affiliate,
  - enhancement of competitive business environment (Li et al., 2013).
- A significant debate and ***inconclusive results***, especially in understanding partnerships in the context of developed and transitional economies (Greenaway et al., 2014 or Du et al., 2012)
- Recent studies put the evidence that benefits for local companies' performance are not automatic: firm should ***be able*** to get benefits (Taglioni and Winkler, 2016)
- In previous paper we observed ***non-significant direct*** relationship between FO and company performance for Russian companies…it looks strange!

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Our guess was….

Probably, smth should “happen” with foreign ownership inside companies allowing to transform opportunities (benefits) that foreign ownership has to company success

One of the explanations is a ***concept of dynamic capabilities*** (Teece, 1997)

Dynamic capability concept

DC *are capacities of a firm to purposefully create, extend, and modify its resource base* (Helfat et al., 2007)

Types of DCs (Zahra and George, 2002, Moore and Fairhurst, 2003, and Wang and Ahmed, 2007, Murray et al., 2011):

- *Absorptive*: identification, acquisition and developing of external resources through the sourcing, transfer and internalization processes (AbsCap)
- *Adaptive:* transformation, integration and reconfiguration of existing resources from various parts of the organization to allowing combining them with newly acquired ones to address changing environments (AdCap)
- *Communicative*: understanding, assimilating and interpreting external information for developing an effective company communication message to customers, foreseeing market opportunities for new products, thereby quickly developing and launching new products to meet customers' preferences (CmCap)

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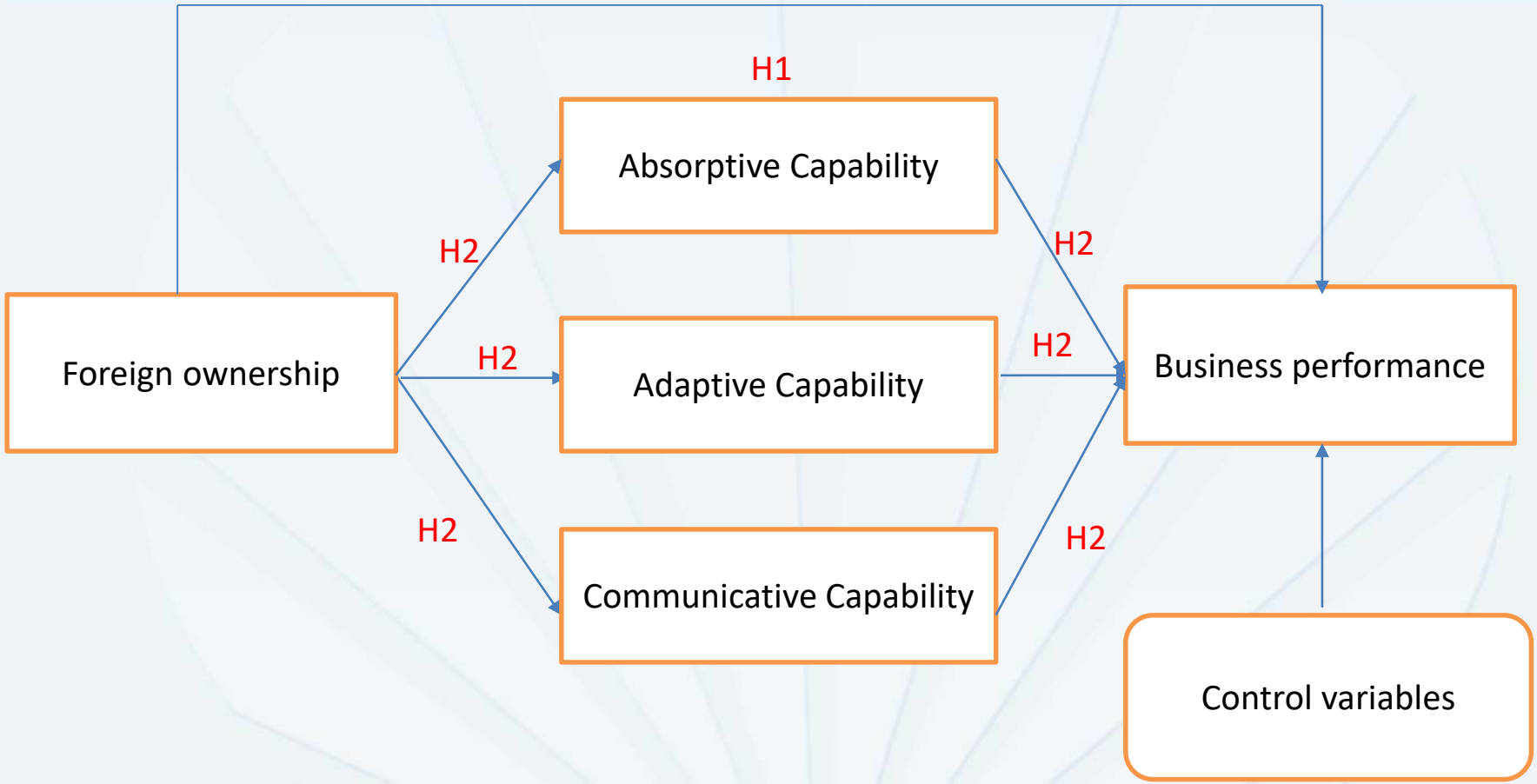
Research Framework



H1: *Foreign ownership positively influence corporate performance (**direct effect**)*

H2: *Without an appropriate level of dynamic capabilities, FDI might not be effectively transform into company performance, thereby outperforming firms reliant on domestic capital (**mediator**)*

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Dataset

- 1,096 Russian companies for the period 2004-14, or 12,056 firm-year observations.
- It presents all economic sectors and corresponds with industry distribution in Russia
- Aside from financial information, the data set contains information regarding
  - the presence of company foreign ownership as a percentage of shares belonging to foreign investors,
  - data related to where the capital originates from
  - data about different types of company's capabilities, collected from publicly available sources.
- The share of companies in our sample with foreign ownership is 26%, which more or less corresponds to the proportion in the Russian economy in general according to Russian Statistics Agency data.

Methodology: PLS-SEM approach

- Partial Least Squares – Structural Equation Model (PLS – SEM) estimation, proposed by Wold (1975) and extended by Lohmooller (1989), applying *SmartPLS 3.0* Software

- Among variance-based SEM techniques, PLS is the most advanced approach to SEM (Dijkstra and Henseler, 2015).

- PLS-SEM is a "*soft-modeling approach*" (Wold, 1980) and advantageous compared to covariance-based SEM in analyzing predictive research models without well-developed theory and for reflective constrcts investigation (Henseler et al., 2016).

- Using of PLS-SEM is advisable in case of investigating secondary data (Gefen et al. 2011).

- The PLS-SEM algorithm transforms non-normal data in accordance with the central limit theorem (Hair et al., 2017).

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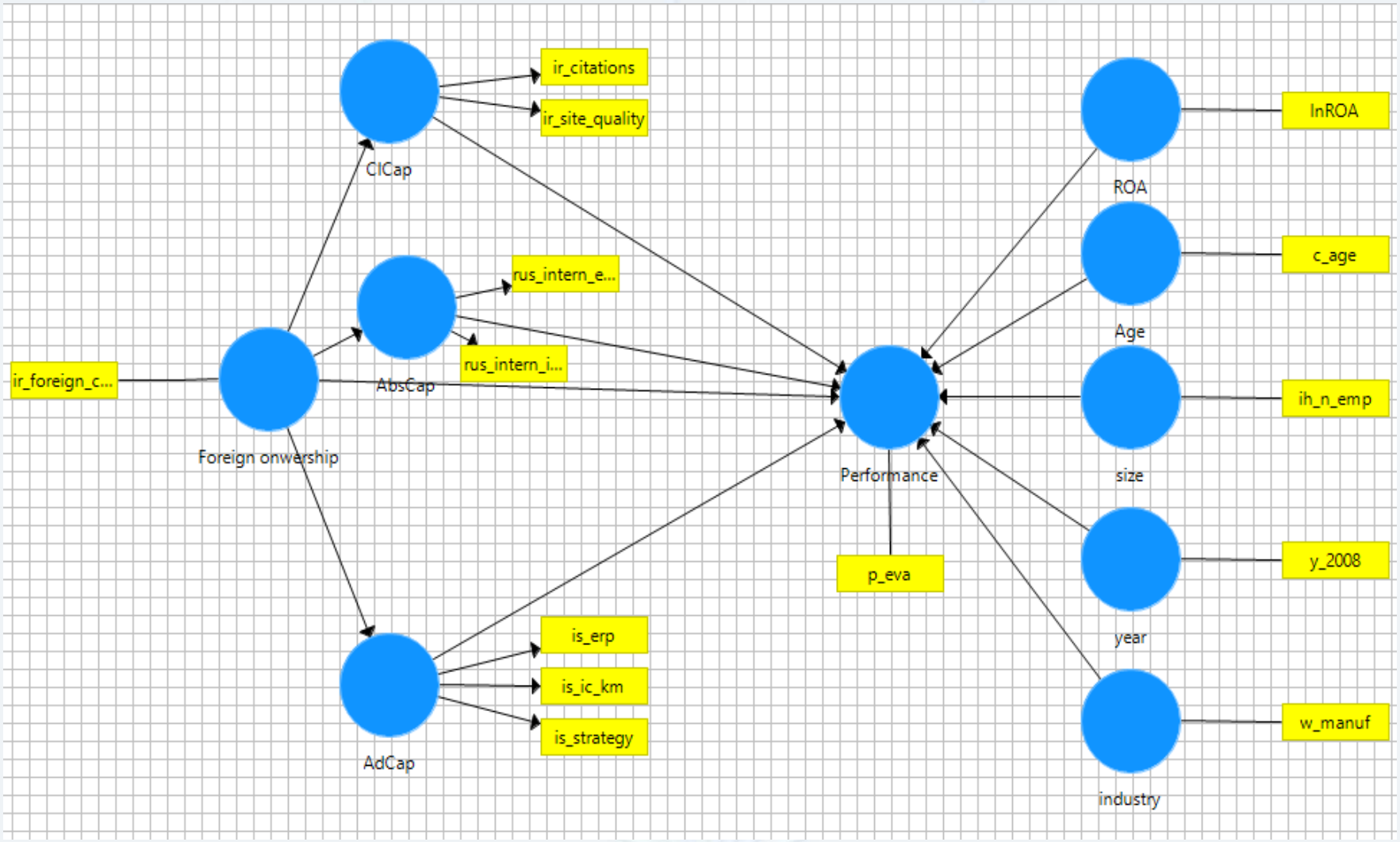
Path diagram



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Descriptive statistics

Variable	Mean	Standard deviation	Min	Max
CIT	2.963	1.516	0	7
SITE	2.105	1.131	0	4
EXP	0.242	0.428	0	1
IMP	0.306	0.461	0	1
KM	0.039	0.193	0	1
ERP	0.130	0.337	0	1
STR	0.190	0.393	0	1
SIZE	4238.000	19376.000	1	456000
AGE	30.000	37.000	0	303
EVA	0.007	0.157	-0.250	0.349
ROA	0.042	0.100	-0.387	0.447
FDI	0.256	0.437	0	1

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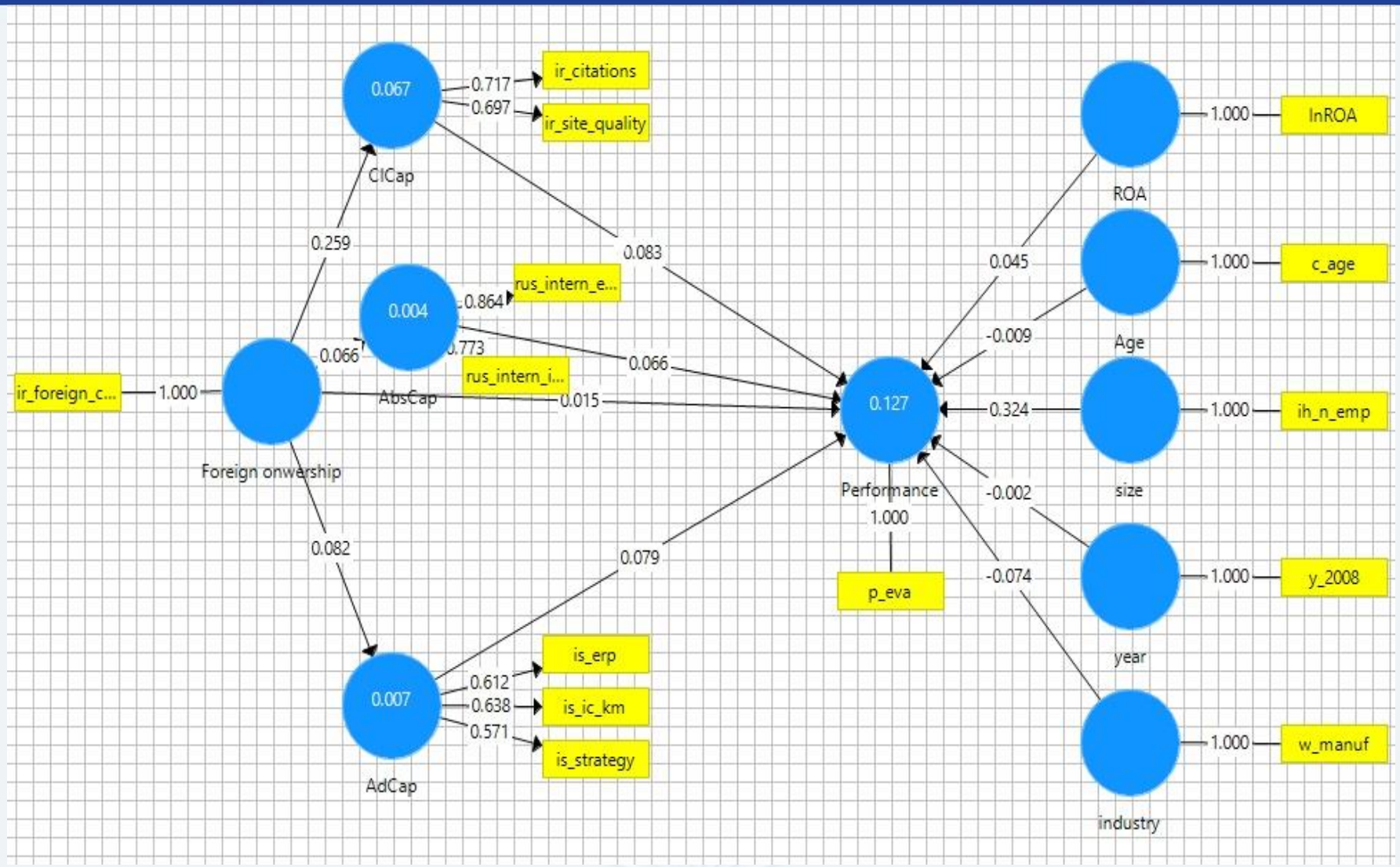
The results of PLS modelling



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Individual item reliability

Factor loadings should be significant and exceeds 0.7

Dep.Var.	EVA			ROA		
Latent variables	AbsCap	AdCap	CmCap	AbsCap	AdCap	CmCap
EXP	0,721***			0,880***		
IMP	0,980***			0,891***		
ERP		0,710***			0,841***	
KM		0,870***			0,714***	
STR		0,701***			0,761***	
CIT			0,868***			0,870***
SITE			0,863***			0,861***

significant at *** 1 percent

Composite Reliability and Validity of Constructs

Cronbach's α and ρ_α (for each construct should exceed 0.6 for exploratory research or studies at the early stage

CR for each construct should exceed 0.7
Average variance extracted (AVE) should exceed 0.50

Dep.Var.	EVA				ROA			
Constructs	Cronbach's α	ρ_α	Composite Reliability	Average Variance Extracted (AVE)	Cronbach's α	ρ_α	Composite Reliability	Average Variance Extracted (AVE)
AbsCap	0,638	0,757	0,788	0,557	0,638	0,677	0,802	0,577
AdCap	0,666	0,666	0,857	0,750	0,666	0,667	0,857	0,750
CmCap	0,725	1,637	0,848	0,740	0,725	0,726	0,879	0,784

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Discriminant Validity of Constructs

Construct's AVE to be larger than the square of its largest correlation with any construct

Latent Variable Correlations (LVC)					
	AbsCap	AdCap	CmCap	Perf	FDI
EVA as performance indicator					
AbsCap	0,860				
AdCap	0,141	0,747			
CmCap	0,286	0,248	0,866		
EVA	0,177	0,149	0,060	Single-item	
FDI	0,146	0,060	0,212	0,068	Single-item
ROA as performance indicator					
AbsCap	0,885				
AdCap	0,141	0,760			
CmCap	0,303	0,274	0,866		
ROA	0,079	0,019	0,081	Single-item	
FDI	0,151	0,068	0,212	0,032	Single-item

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Model estimation

Dependent variable	EVA	ROA
Relations	Coef (St.Dev)	Coef (St.Dev)
Absorptive capability -> Performance	0,061** (0.022)	0,025** (0,009)
Adaptive capability -> Performance	0,060*** (0.009)	0,058*** (0,011)
Communicative capability -> Performance	0,115*** (0.033)	0,061*** (0,008)
Foreign direct investments -> Absorptive capability	0,060*** (0.010)	0,068** (0,007)
Foreign direct investments -> Adaptive capability	0,212*** (0.009)	0,212*** (0,009)
Foreign direct investments -> Communicative capability	0,146*** (0.011)	0,151*** (0,010)
Foreign direct investments -> Performance	0,002 (0.010)	0,008 (0,009)
AGE -> Performance	-0,010* (0.005)	-0,013 (0,009)
SIZE -> Performance	0,300*** (0.062)	0,020*** (0,005)
IND -> Performance	Included	Included
YEAR -> Performance	Included	Included
Number of observations	10,860	10,860

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Number of observations	10,860	10,860

Results

- H1 and H2 are rejected as direct effect of foreign ownership is insignificant and the effect totally goes from links through dynamic capabilities

- In contrary with Hsu and Chen (2009), the findings indicate the confirmation for *full mediating role* of dynamic capabilities between foreign ownership and business performance

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Evaluation of magnitude and significance of mediation effects

Corp.Perf. indicator	Relations	Direct effect	Indirect effect	Total indirect effect	Total effect	VAF, %	StDev	Z-values	p-value
EVA	FDI-Perf	0,002			0,035			0,897	0.370
	AbsCap-FDI-Perf		0,004	0,033		10,4	0.006	0,599	0.000
	AdCap-FDI-Perf		0,013			36,4	0.002	5,238	0.000
	CmCap-FDI-Perf		0,017			47,7	0.004	4,711	0.000
ROA	FDI-Perf	0,008			0,031				0.371
	AbsCap-FDI-Perf		0,002	0,023		5,4	0.001	1,170	0.000
	AdCap-FDI-Perf		0,012			39,4	0.001	17,984	0.000
	CmCap-FDI-Perf		0,009			29,5	0.002	3,877	0.000

Results

- the indirect paths are positive and significant, accounting 94 and 74% in total effect for EVA and ROA, consequently
- For value creation communicative capability is the most influential part of firm DCS constructs – 47.7% of total effect, while for operation efficiency adaptive capability accounts 39.4% of total effect
- Our results are in the line with Uhlenbruck et al. (2003) who claimed that an initial low endowment of firm-specific assets makes foreign ownership one of the major channels for upgrading existing resources

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Conclusion

- For better performance through FDI, firms from emerging market should invest into development of absorptive, adaptive and communicative capabilities
- Sustainable positive spillovers from foreign capital originate from local companies' ability to accumulate and utilize internal resources and communicate with external environment
- Dynamic capabilities are powerful tools that can indirectly lead to superior performance via significant change to a firm's resource base as positive spillover of FDI
- It becomes increasingly important for local firms to invest in learning activities for reducing the knowledge gap between MNEs and affiliates, thereby be able to absorb knowledge, discover opportunities and threats, efficient to reconfigure their resources.