

# Study explores how local firms should adopt market, nonmarket strategies in the face of foreign direct investment

June 18 2024

---



Credit: CC0 Public Domain

Studies have shown how inward foreign direct investment (FDI) increases the productivity or innovation of local firms in emerging

markets, but little research has explored how local firms have to strategically cope with this competition.

Upon exploring these connections, a [new article](#) in the *Global Strategy Journal* recommends that local firms adopt a balanced approach to contend with these competition challenges: Companies should adopt both market and nonmarket strategies to maximize benefits, as relying solely on political connections may not be the most effective option.

FDI refers to when a company purchases a business or sets up new operations in a country different from the one of its origin. Local firms do benefit from knowledge spillovers from foreign firms, but they also face the harm of the competition they bring to the [local market](#), which they can address via two routes: Market strategies focus on being competitive within the marketplace, while nonmarket strategies aim to shape the market environment by way of—for example—regulation or public opinion.

Meitong Dong of The University of Hong Kong, Pengcheng Ma of Renmin University of China, and Lin Cui of Australian National University wanted to clarify the relationship among foreign firms, local firms, and the local [government](#). The researchers drew from resource dependence theory to argue that when there is a low to moderate level of inward FDI, its overall spillover benefits can alleviate local firms' dependence on the government for some resources, which reduces the need for political connections.

However, when inward FDI grows to a moderate to high level, the competitive threats it poses to local firms begin to outweigh the spillover benefits, which in turn motivates local firms to foster stronger connections with the government in an effort to neutralize foreign firms' competitive advantages.

To test their theory, the team used China as its research setting because it both represents an emerging economy and is one of the largest recipients of foreign investment. The study used a sample of 1,463 Chinese listed firms from 2009 to 2017, along with data that measured FDI and the local firms' political connections. They also used governmental R&D funding, institutional development, and market diversification to reflect the resource similarity offered by foreign firms and the local government.

The research team identified a U-shaped relationship between inward FDI and local firms' political connections. The authors also argue that when the resources from foreign firms and the government are similar in type, local firms' nonmarket strategies—their political connections—are more responsive to inward FDI. This occurs because the spillover benefits of inward FDI are more likely to be substitutable for government resources; at the same time, the competitive threats can be neutralized if local firms can secure matching resources from the government. Therefore, the U-shaped relationship is more pronounced when the resource similarity is high.

"For firms in emerging markets, relying solely on the government cannot be the perfect way to tackle the competition brought by inward FDI," the authors say. "Local firms should consider market and nonmarket strategies in the face of inward FDI and how to combine the two strategies to optimize their benefits. Furthermore, local firms should try to understand the similarities between the resources provided by inward FDI and the government when implementing market and nonmarket strategies."

**More information:** Meitong Dong et al, Inward FDI and local firms' political connections in emerging markets: Evidence from China, *Global*

*Strategy Journal* (2024). [DOI: 10.1002/gsj.1503](https://doi.org/10.1002/gsj.1503)

Provided by Strategic Management Society

Citation: Study explores how local firms should adopt market, nonmarket strategies in the face of foreign direct investment (2024, June 18) retrieved 21 June 2024 from <https://phys.org/news/2024-06-explores-local-firms-nonmarket-strategies.html>

This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.