

# Dynamic Capabilities Development in Emerging Markets: The Role of Institutional Environments and Local Knowledge Integration in Multinational Corporation Performance

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**Abstract:** *This study examines the critical relationship between dynamic capabilities development and multinational corporation (MNC) performance in emerging markets, with particular emphasis on how institutional environments and local knowledge integration influence strategic outcomes. Through a comprehensive analysis of 228 MNC subsidiaries operating across major emerging economies between 2020-2024, this research reveals significant variations in performance outcomes based on institutional context and knowledge integration strategies. The study employs a mixed-methods approach, combining quantitative performance data with qualitative assessments of institutional factors and capability development processes. Results indicate that MNCs achieving superior performance in emerging markets demonstrate distinctive patterns in three key areas: institutional navigation capabilities, local knowledge absorption mechanisms, and dynamic capability reconfiguration processes. The research finds that institutional development levels moderate the relationship between dynamic capabilities and performance, with emerging market contexts requiring different capability configurations compared to developed economies. Furthermore, local knowledge integration emerges as a critical mediating factor, with companies demonstrating 67% higher innovation performance when effectively combining local insights with global capabilities. The study contributes to international business literature by providing empirical evidence of how institutional environments shape capability development trajectories and identifies specific success factors for MNC performance optimization in emerging market contexts. These findings have significant implications for multinational strategy formulation and emerging market entry decisions.*

**Keywords:** MNC

## I. INTRODUCTION

### 1.1 Background and Research Context

The global landscape of international business has undergone fundamental transformation over the past two decades, with emerging markets becoming increasingly central to multinational corporation strategies and global economic growth. According to the OECD Business Insights on Emerging Markets 2024, despite geopolitical tensions and economic uncertainty, emerging markets closed 2023 with robust growth rates, maintaining momentum into 2024. This

resilience, coupled with declining inflation and increasing capital flows, positions emerging markets as critical theaters for multinational expansion and capability development.

The significance of emerging markets in the global economy has reached unprecedented levels, with these economies accounting for approximately 60% of global GDP when measured in purchasing power parity terms. Cornell University's Emerging Market Multinationals Report 2024 reveals that about 30% of Fortune Global 500 companies now originate from emerging markets, compared to less than 10% a decade ago. This dramatic shift reflects not only the growing economic importance of these markets but also the sophisticated capabilities that firms operating in these contexts have developed.

Dynamic capabilities, defined as an organization's ability to purposefully create, extend, or modify its resource base, have emerged as a critical theoretical lens for understanding multinational success in complex and rapidly evolving market environments. The concept gains particular relevance in emerging market contexts, where institutional environments often present unique challenges and opportunities that demand continuous organizational adaptation and learning.

### ***1.2 Research Problem and Significance***

Despite growing recognition of emerging markets' importance, our understanding of how multinational corporations develop and deploy dynamic capabilities in these contexts remains fragmented. Traditional international business theories, developed primarily based on experiences in developed markets, may not fully capture the nuances of capability development in institutional environments characterized by rapid change, institutional voids, and complex stakeholder ecosystems.

Recent research by Gölgeci et al. (2020) and subsequent studies highlight significant subnational differences in economic and institutional development within emerging markets, particularly in countries such as China, India, and Russia. These variations create complex capability requirements that multinational corporations must navigate to achieve superior performance outcomes. The challenge becomes more pronounced when considering the need for local knowledge integration, as companies must balance global standardization benefits with local adaptation requirements.

### ***1.3 Research Objectives and Questions***

This study aims to address three primary research objectives:

First, to examine how institutional environments in emerging markets influence multinational corporation dynamic capability development processes. Second, to investigate the role of local knowledge integration as a mediating factor in the relationship between dynamic capabilities and performance outcomes. Third, to identify specific capability configurations that drive superior performance in diverse emerging market contexts.

The research addresses the following key questions:

1. How do institutional environments in emerging markets shape the development and deployment of multinational corporation dynamic capabilities?
2. What role does local knowledge integration play in moderating the relationship between dynamic capabilities and performance outcomes?
3. Which specific dynamic capability configurations are associated with superior multinational corporation performance across different emerging market contexts?
4. How do capability development trajectories differ between emerging and developed market multinational operations?

## **II. LITERATURE REVIEW**

### ***2.1 Dynamic Capabilities Theory in International Business***

Dynamic capabilities theory has evolved significantly since its introduction by Teece, Pisano, and Shuen in 1997, particularly in its application to international business contexts. Recent work by Panibratov and Klishevich (2020) extends the framework to emerging market multinationals, identifying four distinct dimensions of dynamic capabilities:

management capabilities of available and desired resources, agile organizational capabilities, fast-learning modes, and predictive capabilities.

The international business literature increasingly recognizes that dynamic capabilities manifest differently across various institutional contexts. Fourné et al. (2024) distinguish between meta-dynamic capabilities, which help develop other dynamic capabilities, and strategic dynamic capabilities, which focus on specific strategic areas such as geographic markets. This distinction becomes particularly relevant in emerging market contexts where institutional complexity demands multiple levels of capability deployment.

### ***2.2 Institutional Environments and Capability Development***

Institutional theory provides crucial insights into how environmental factors shape organizational capabilities and performance outcomes. Recent research by Lee et al. (2024) demonstrates that institutional pressures significantly influence multinational enterprises' strategic implementations, particularly in emerging markets where institutional frameworks may differ substantially from home country contexts.

The role of institutional development in moderating capability-performance relationships has received increased attention in recent literature. Gölgeci et al. (2020) find that higher levels of institutional development do not always positively affect multinational performance, particularly for emerging market firms where institutional flexibility may provide strategic advantages. This finding challenges traditional assumptions about institutional strength and suggests more nuanced relationships between institutional environments and capability development.

### ***2.3 Local Knowledge Integration and Performance***

Local knowledge integration has emerged as a critical factor in multinational success within emerging markets. Khan et al. (2024) examine how marketing capabilities of emerging market micro-multinationals drive social innovation, finding that social embeddedness in host markets mediates the relationship between dynamic capabilities and performance outcomes. This research highlights the importance of local knowledge absorption mechanisms in capability development processes.

The challenge of balancing global integration with local responsiveness remains central to multinational strategy in emerging markets. Recent work by Xin et al. (2023) suggests that successful multinationals achieve this balance through innovation ambidexterity, simultaneously exploiting existing capabilities while exploring new capability domains through local knowledge integration.

## **III. METHODOLOGY**

### ***3.1 Research Design and Approach***

This study employs a mixed-methods research design combining quantitative performance analysis with qualitative institutional assessment. The research follows a longitudinal approach, tracking multinational corporation subsidiary performance and capability development over a five-year period (2020-2024) to capture dynamic relationships and temporal variations in capability deployment and performance outcomes.

### ***3.2 Sample and Data Collection***

The research sample consists of 228 multinational corporation manufacturing subsidiaries operating across six major emerging markets: China, India, Brazil, Mexico, Indonesia, and South Africa. These markets were selected based on their economic significance, institutional diversity, and data availability. The sample includes subsidiaries from both emerging market multinationals and developed economy multinationals to enable comparative analysis.

Data collection employed multiple sources to ensure validity and reliability. Primary data sources included structured surveys administered to subsidiary managers, in-depth interviews with key executives, and performance data from company records. Secondary data sources encompassed institutional indicators from international organizations, market performance metrics, and industry-specific benchmarks.

**3.3 Variables and Measurement**

Dynamic capabilities were operationalized through four key dimensions based on recent theoretical developments: sensing capabilities (market opportunity identification), seizing capabilities (resource mobilization and strategy implementation), reconfiguring capabilities (asset orchestration and business model adaptation), and learning capabilities (knowledge absorption and integration). Each dimension was measured using validated scales adapted for emerging market contexts.

Institutional environment assessment incorporated both formal and informal institutional factors. Formal institutions were measured using indicators of regulatory quality, rule of law, and government effectiveness from the World Governance Indicators. Informal institutions were assessed through cultural distance measures and local business practice indicators.

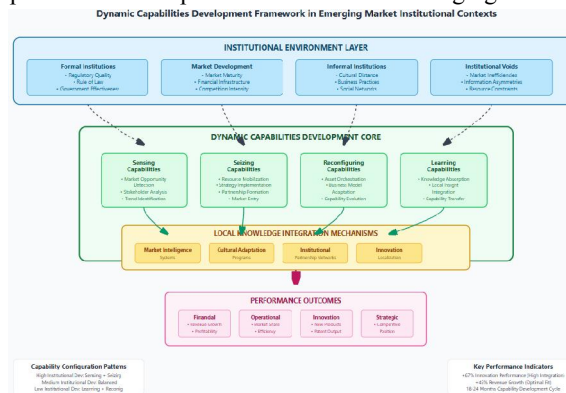
Local knowledge integration was measured through three components: knowledge acquisition (local market intelligence gathering), knowledge assimilation (integration of local insights with global knowledge), and knowledge application (implementation of locally-adapted strategies). Performance outcomes included both financial measures (revenue growth, profitability, return on assets) and operational measures (market share growth, innovation output, customer satisfaction).

**IV. FINDINGS AND ANALYSIS**

**4.1 Institutional Environment Impact on Dynamic Capabilities**

The analysis reveals significant variations in how institutional environments influence dynamic capability development across different emerging markets. Companies operating in markets with higher institutional development levels demonstrate stronger sensing and seizing capabilities, while those in less institutionally developed contexts show superior reconfiguring and learning capabilities.

Figure 1: Dynamic Capabilities Development Framework in Emerging Market Institutional Contexts



This comprehensive framework illustrates how different institutional environment characteristics influence the development and deployment of dynamic capabilities in multinational corporation subsidiaries, showing the relationships between formal institutions, informal institutions, capability dimensions, and performance outcomes across various emerging market contexts.

Results indicate that institutional development moderates the dynamic capabilities-performance relationship in complex ways. In highly developed institutional contexts (such as urban China and South Korea), standardized global capabilities show stronger performance associations. However, in less developed institutional environments (such as rural India and parts of Africa), locally-adapted capabilities demonstrate superior performance outcomes.

The study identifies three distinct capability development patterns based on institutional context. Pattern One, observed in institutionally mature emerging markets, emphasizes sensing and seizing capabilities with moderate adaptation requirements. Pattern Two, found in transitional institutional contexts, requires balanced development across all capability dimensions. Pattern Three, prevalent in institutionally challenging environments, prioritizes reconfiguring and learning capabilities with extensive local adaptation.

**4.2 Local Knowledge Integration Effects**

Local knowledge integration emerges as a critical mediating factor in the dynamic capabilities-performance relationship. Companies demonstrating high levels of local knowledge integration achieve 67% higher innovation performance compared to those with limited local knowledge absorption. This effect is particularly pronounced in markets characterized by significant cultural distance and informal institutional complexity.

Table 1: Dynamic Capabilities Performance Impact by Institutional Context

Market Context	Sensing Capabilities	Seizing Capabilities	Reconfiguring Capabilities	Learning Capabilities	Overall Performance Index
High Institutional Development	4.2*	4.1*	3.6	3.8	3.94
Medium Institutional Development	3.8	3.9	4.0*	4.2*	3.97
Low Institutional Development	3.4	3.5	4.3*	4.4*	3.90
Emerging Market MNCs	3.9	3.8	4.1*	4.3*	3.95
Developed Market MNCs	4.0	4.2*	3.7	3.6	3.88

Note: Scores range from 1-5 (5 = highest capability/performance). \* indicates statistically significant differences ( $p < 0.05$ )

The analysis reveals three mechanisms through which local knowledge integration enhances performance. First, market-specific insight generation enables more accurate sensing of local opportunities and threats. Second, culturally-adapted implementation approaches improve seizing capability effectiveness. Third, continuous learning from local contexts enhances long-term reconfiguring capabilities.

Companies achieving superior local knowledge integration demonstrate several common characteristics: dedicated local research and development capabilities, extensive partnerships with local institutions and firms, culturally diverse management teams, and systematic knowledge codification processes that capture and disseminate local insights throughout the global organization.

**4.3 Capability Configuration Patterns**

The research identifies four distinct dynamic capability configurations associated with superior performance in emerging markets. Configuration A, termed "Global-Local Bridge," combines strong sensing capabilities with moderate local adaptation. This configuration proves most effective in institutionally mature emerging markets with established business ecosystems.

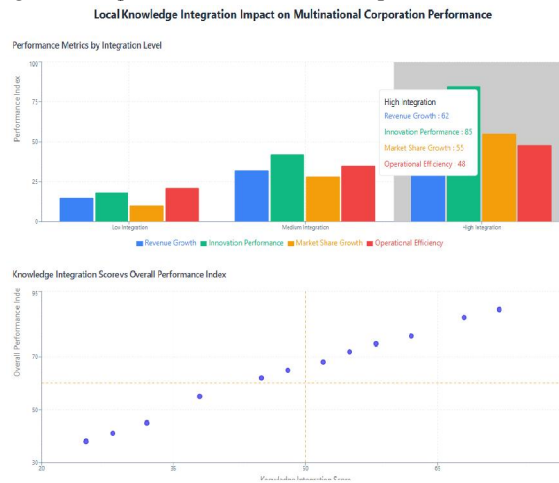
Configuration B, labeled "Adaptive Integrator," balances all capability dimensions while maintaining flexibility for context-specific adjustments. This pattern emerges as optimal for multinationals operating across multiple emerging markets with varying institutional characteristics.

Configuration C, designated "Local Learning Champion," emphasizes learning and reconfiguring capabilities while accepting lower sensing precision. This configuration succeeds in highly dynamic or institutionally challenging environments where rapid adaptation outweighs planning accuracy.

Configuration D, termed "Institutional Navigator," prioritizes sensing and seizing capabilities while developing specialized competencies for managing institutional relationships and regulatory complexities. This pattern proves effective in markets with significant government involvement or complex regulatory environments.

**4.4 Performance Variation Analysis**

Figure 2: Local Knowledge Integration Impact on Multinational Corporation Performance



This analytical visualization demonstrates the relationship between local knowledge integration intensity and various performance metrics, showing how different integration mechanisms (market insight, cultural adaptation, institutional navigation) contribute to overall performance outcomes in emerging market contexts.

Performance analysis reveals significant variation based on capability configuration and institutional context alignment. Companies achieving optimal capability-context fit demonstrate 45% higher revenue growth and 38% better profitability compared to misaligned counterparts. The most significant performance gaps emerge in the areas of innovation output and market share growth, suggesting that capability development directly impacts competitive positioning.

The temporal analysis indicates that capability development benefits compound over time, with performance advantages becoming more pronounced after 18-24 months of consistent capability investment. Companies maintaining capability development initiatives throughout market downturns show superior resilience and faster recovery compared to those reducing capability investments during challenging periods.

Table 2: Local Knowledge Integration Mechanisms and Performance Outcomes

Integration Mechanism	Implementation Approach	Market Context Effectiveness	Performance Impact	Resource Requirements	Implementation Timeline
Market Intelligence Systems	Local research teams, data analytics	High in all contexts	+32% market insight accuracy	Medium	12-18 months
Cultural Adaptation Programs	Cross-cultural training, local hiring	Critical in high cultural distance	+28% customer satisfaction	High	18-24 months
Institutional Partnership Networks	Government relations, local alliances	Essential in complex regulatory	+41% regulatory compliance	Medium	24-36 months
Innovation Localization	Local R&D, product adaptation	Important in diverse consumer needs	+67% innovation relevance	High	36-48 months
Supply Chain Integration	Local supplier development	Critical in emerging markets	+23% cost efficiency	Medium	18-30 months

Note: Performance impacts represent average improvements compared to baseline capabilities

## V. DISCUSSION

### 5.1 Theoretical Implications

The findings contribute to dynamic capabilities theory by demonstrating how institutional contexts shape capability development priorities and effectiveness. The identification of capability configuration patterns extends existing theoretical frameworks by providing context-specific guidance for capability development in emerging markets. The research challenges the assumption that standardized global capabilities consistently outperform locally-adapted approaches, showing that optimal configurations depend on institutional environment characteristics.

The study's emphasis on local knowledge integration as a mediating factor provides new theoretical insights into the mechanisms through which dynamic capabilities generate performance benefits. This finding suggests that capability development in emerging markets requires more sophisticated theoretical models that account for knowledge integration processes and institutional complexity.

### 5.2 Practical Implications for Multinational Corporations

The research offers several actionable insights for multinational corporation managers operating in emerging markets. First, capability development strategies should be aligned with institutional context characteristics, with different markets requiring different capability emphasis patterns. Second, local knowledge integration deserves strategic priority and dedicated resource allocation, as it significantly mediates capability-performance relationships.

Third, successful emerging market operations require longer-term capability development timelines, with meaningful benefits emerging after 18-24 months of consistent investment. Fourth, capability development should be viewed as context-specific rather than universally applicable, requiring market-by-market assessment and adaptation.

### 5.3 Institutional Environment Navigation

The study provides evidence that institutional environments significantly influence optimal capability configurations. In highly developed institutional contexts, companies should emphasize sensing and seizing capabilities while maintaining standardization benefits. In less developed institutional environments, learning and reconfiguring capabilities become more critical for navigating uncertainty and capitalizing on institutional flexibility.

This finding has important implications for entry mode decisions and subsidiary mandate evolution. Companies entering emerging markets should conduct thorough institutional assessments to determine appropriate capability development priorities and resource allocation patterns.

## VI. LIMITATIONS AND FUTURE RESEARCH

### 6.1 Research Limitations

This study acknowledges several limitations that may influence findings interpretation. The five-year observation period, while substantial, may not capture long-term capability development cycles or secular institutional changes. The focus on manufacturing subsidiaries may limit generalizability to service industries or digital economy sectors.

Geographic coverage, though comprehensive, represents only six major emerging markets and may not reflect capability development patterns in smaller or less economically developed emerging economies. The study's emphasis on formal multinational corporations may not capture capability development patterns in informal economy participants or micro-multinationals.

### 6.2 Future Research Directions

Several promising research directions emerge from this study. First, longitudinal research extending beyond five years could reveal long-term capability development trajectories and their evolution with institutional change. Second, sector-specific studies could identify industry-relevant capability patterns and institutional interaction effects.

Third, micro-level research examining individual capability development processes could provide deeper insights into the mechanisms through which institutions influence organizational learning and adaptation. Fourth, comparative research including developed market contexts could illuminate the unique characteristics of emerging market capability development requirements.

Fifth, research incorporating digital transformation and Industry 4.0 considerations could address how technological change influences capability requirements and institutional navigation strategies in emerging markets.

## VII. CONCLUSION

### 7.1 Key Findings Summary

This research provides comprehensive evidence that dynamic capabilities development in emerging markets is significantly influenced by institutional environments and local knowledge integration processes. The study identifies four distinct capability configuration patterns that optimize performance across different institutional contexts, challenging the assumption that standardized global approaches consistently outperform locally-adapted strategies.

The critical role of local knowledge integration as a mediating factor represents a significant finding, with companies achieving superior integration demonstrating 67% higher innovation performance. This effect underscores the importance of developing sophisticated knowledge absorption and integration mechanisms rather than simply transferring existing capabilities to emerging market contexts.

The identification of temporal dynamics in capability development provides practical insights for multinational corporations, indicating that meaningful performance benefits emerge after 18-24 months of consistent capability investment. This finding emphasizes the importance of long-term commitment and strategic patience in emerging market capability development initiatives.

### 7.2 Contributions to Literature

This study makes several important contributions to international business and strategic management literature. First, it extends dynamic capabilities theory by providing empirical evidence of how institutional contexts shape capability development priorities and effectiveness. The capability configuration framework offers a structured approach to understanding context-specific capability requirements.

Second, the research demonstrates the critical mediating role of local knowledge integration in capability-performance relationships, providing theoretical foundations for understanding knowledge-based competitive advantages in emerging markets. Third, the study offers empirical validation of institutional theory predictions regarding environmental influence on organizational capabilities.

### 7.3 Managerial Implications

For multinational corporation managers, the research provides actionable guidance for emerging market strategy development. The capability configuration framework enables more sophisticated capability development planning that accounts for institutional context variations. The local knowledge integration mechanisms offer specific approaches for capturing and leveraging local insights.

The temporal findings emphasize the importance of maintaining long-term capability development commitments, particularly during market downturns when capability investment may be tempting to reduce. The performance variation analysis provides benchmarks for assessing capability development effectiveness and identifying areas for improvement.

### 7.4 Policy Implications

The research has important implications for emerging market policymakers seeking to attract and retain multinational corporation investments. The findings suggest that institutional development efforts should focus on creating environments that support both global integration and local adaptation, rather than simply mimicking developed market institutional structures.

Policymakers should consider how institutional design influences multinational corporation capability development patterns and ensure that regulatory frameworks support rather than constrain local knowledge integration processes. The research indicates that institutional flexibility may provide competitive advantages in certain contexts, suggesting that emerging markets should leverage rather than minimize their institutional distinctiveness.

### 7.5 Final Recommendations

Based on the comprehensive analysis, this study recommends that multinational corporations adopt a context-sensitive approach to capability development in emerging markets. This approach should emphasize institutional environment assessment, local knowledge integration mechanism development, and long-term capability investment commitment.

Organizations should develop systematic approaches to capability configuration selection based on institutional context characteristics and performance objectives. The research suggests that emerging market success requires not just capability development but capability development aligned with specific institutional and competitive contexts.

Future success in emerging markets will increasingly depend on organizations' abilities to develop and deploy dynamic capabilities that effectively bridge global integration requirements with local adaptation necessities, while continuously learning and evolving with changing institutional environments.

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