

*Investing Abroad Directly*  
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## ■ Learning Objectives

- Understand the **vocabulary** associated with **foreign direct investment (FDI)**.
- Explain how **ownership, location & internalization (OLI)** advantages lead to **FDI**.
- Explain how **home & host country institutions** affect **FDI**.
- Analyze the **benefits & costs** of **FDI** to host & home countries.
- Draw **managerial relevance**.



- ▶ **1. Opening Case: Entering the Global Stage**
- 2. FDI Vocabulary
- 3. MNC-Based Theoretical Framework
- 4. National Institutions & FDI
- 5. Benefits & Costs of FDI for Host Countries
- 6. Internationalization of Asian Firms
- 7. Conclusive Remarks

# Opening Case: Entering the Global Stage



## ■ Spanish MNCs



- > Spanish MNEs have been a **latecomer** to IB due to a **history** of dictatorship that ended in 1975.
- > **6th** largest recipient of & **8th** largest source of FDI
- > In the **1990s**, Spanish MNEs expanded abroad.

- > Ferrovial's **M&A strategy**.
  - Acquired construction businesses & airport operators (e.g., Gatwick & Heathrow) across Europe.



1. Opening Case: Entering the Global Stage



**2. FDI Vocabulary**

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# FDI Vocabulary



## ■ Horizontal FDI

### Operations in Home Country



### Horizontal FDI



### Operations in Host Country



# FDI Vocabulary



## ■ Vertical FDI

### Operations in Home Country



### Operations in Host Country



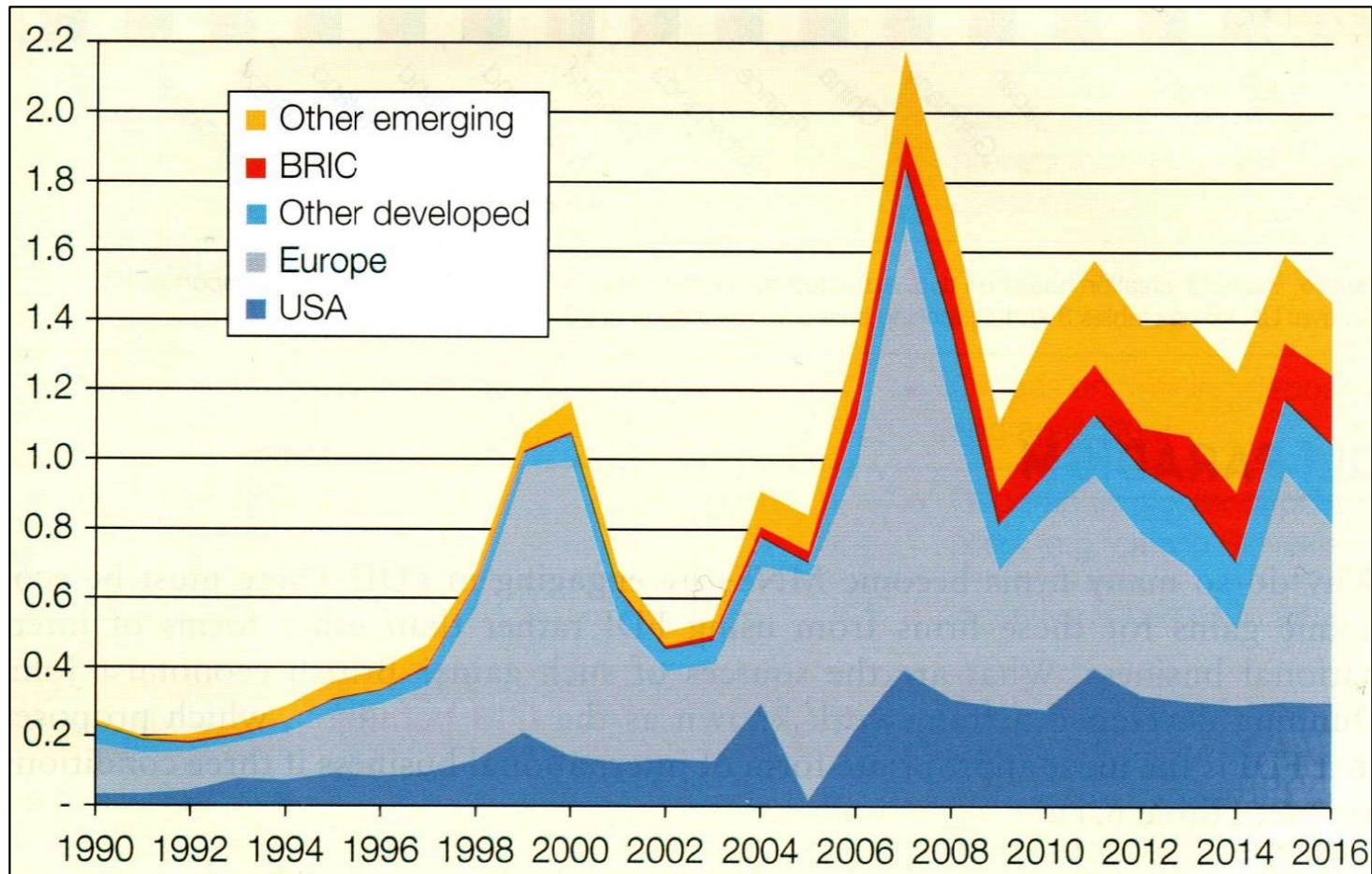
Upstream  
Vertical FDI

Downstream  
Vertical FDI





## ■ FDI Outflows (US\$ Trillion)



Source: Peng & Meyer (2019: 155).





1. Opening Case: Entering the Global Stage

2. FDI Vocabulary



**3. MNC-Based Theoretical Framework**

4. National Institutions & FDI

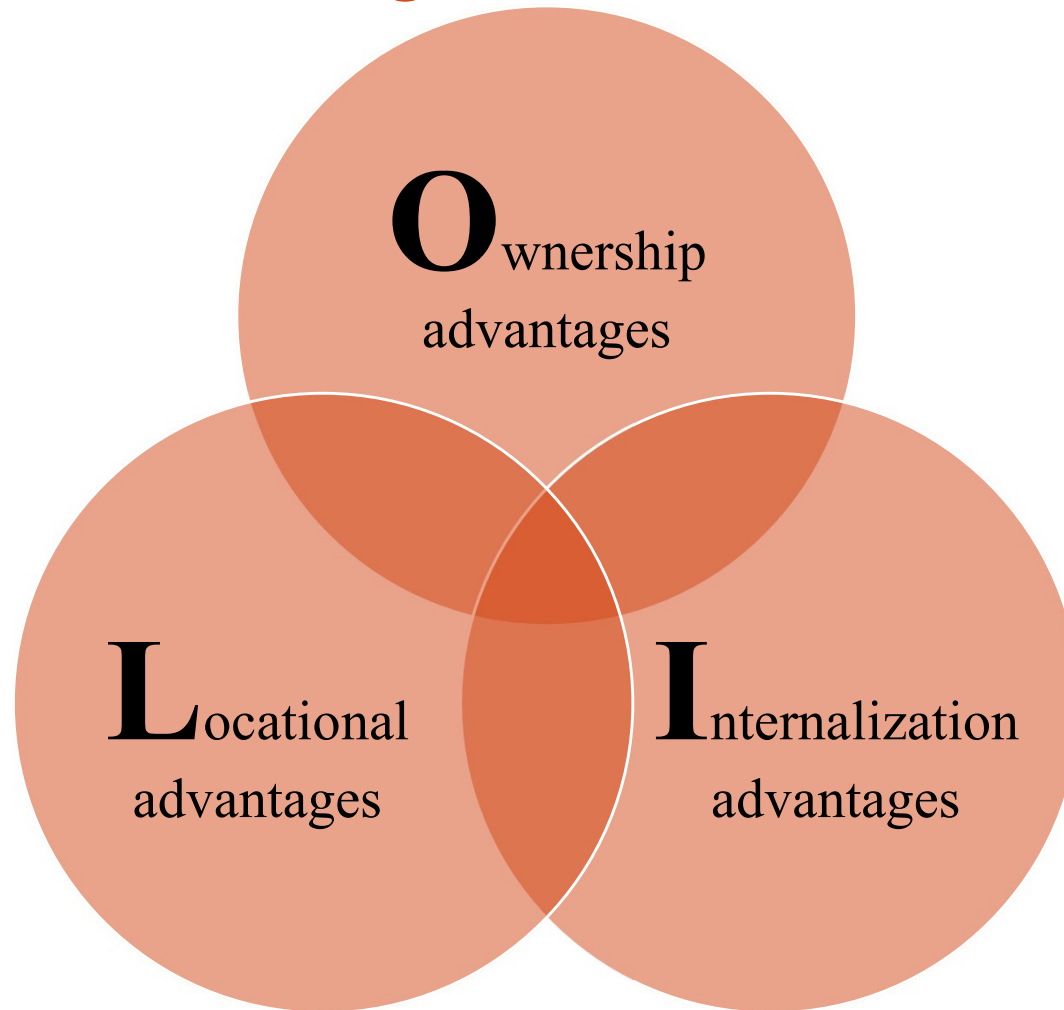
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## ■ OLI Configuration in Hierarchical Capitalism



### KEY WORDS

#### > **Ownership:**

- ❖ Resources of the firm that are transferable across borders.
- ❖ Resources that enable the firm to attain competitive advantage.

#### > **Location:**

- ❖ Advantages enjoyed by firms operating in certain locations.
- ❖ Access to local markets & to resources (e.g., human capital & raw materials).

#### > **Internalization:**

- ❖ Advantages of organizing activities within a MNC rather than using a market transaction.

# MNC-Based Theoretical Framework



## ■ OLI Paradigm: 1 O-Advantages 2 L-Advantages 3 I-Advantages

### COMBINING BUSINESS UNITS

- > **Logistics** based on **superior coordination** between business units in different locations.



### SHARING RESOURCES

- > Sharing of business model, **brand name** & image across stores.



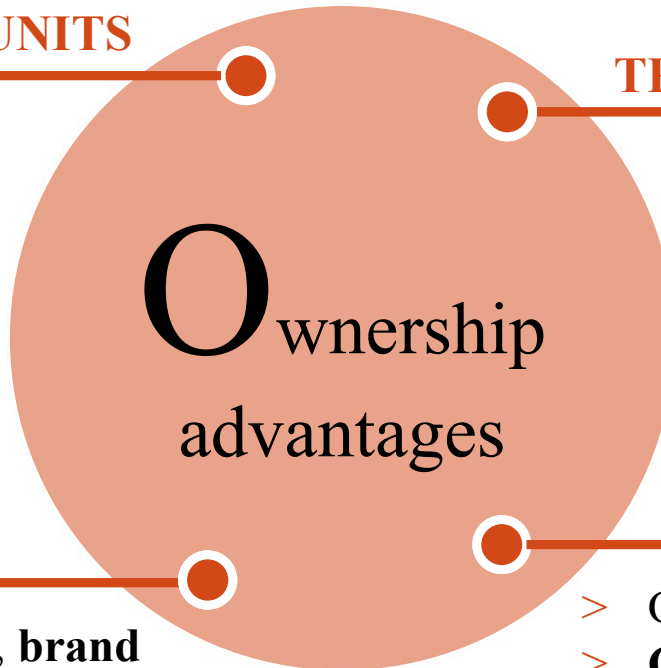
### TRANSFERABLE RESOURCES

- > **Proprietary knowledge.**
- > **Managerial know-how.**



### ORGANIZATIONAL STRUCTURES & CULTURE

- > **Operation manuals.**
- > **Codes of conduct.**
- > **Organizational norms & practices.**



# MNC-Based Theoretical Framework



## ■ J&J's Credo Value (<http://www.youtube.com/watch?v=hOt86vjS6Ro>)

❖ **Credo** is a **one-page ethical code of conduct** that guides how J&J fulfills its business responsibilities.

- **Doctors, nurses, patients, customers, suppliers & distributors:** High-quality products and services.
- **Employees:** Respect & dignity, fair & adequate compensation, a sense of security in their jobs.
- **Communities:** Better health & education.
- **Stakeholders:** A sound profit & a fair return, new equipment, new facilities, new products, new ideas.

**“Essentially, the business will be well served by putting the Customer First! Shareholders Last!”**

# MNC-Based Theoretical Framework



## ■ OLI Paradigm: 1 O-Advantages 2 L-Advantages 3 I-Advantages

### MARKETS

- > Size & growth of **consumer demand** (e.g., China, Vietnam, India).
- > Presence of **key clients**.
- > **High-income** consumers (Haier in the USA).

### INSTITUTIONS

- > **FDI incentives**.
  - Corporate tax reduction.
  - Tax exemption.
  - Grants.
  - Investment promotion agencies.

### AGGLOMERATION

- > **Geographic cluster** of potential customers & suppliers.
  - Cars in European transition economies.
  - IT clusters in Silicon valley.

### LOCATION-BOUND RESOURCES

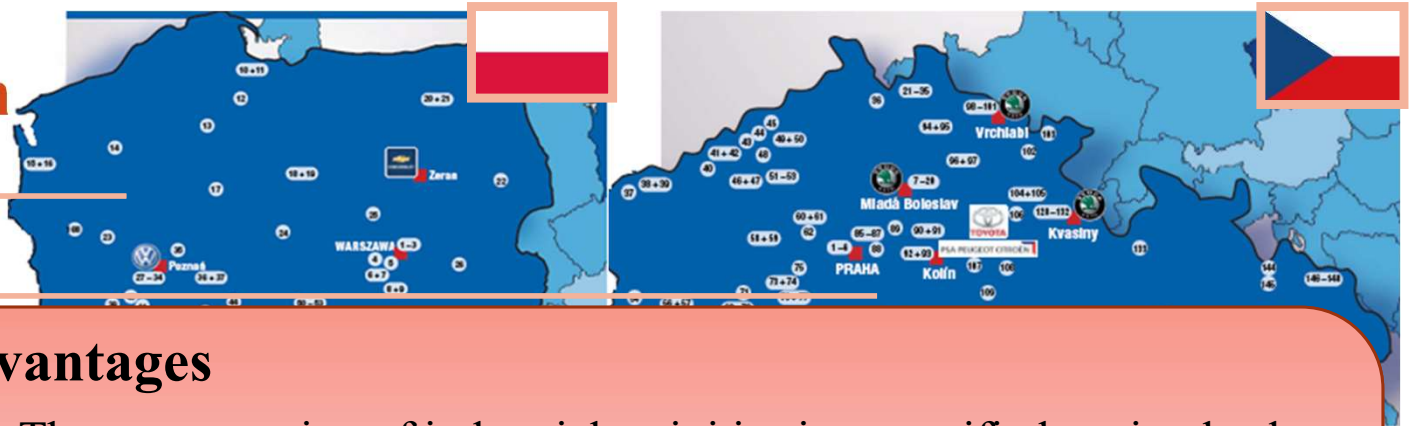
- > **Human capital** (e.g., skilled labor force).
- > **Natural resources** (e.g., oil & gas deposits by BP).
- > Agriculture.

Location advantages

# MNC-Based Theoretical Framework



## ■ Agglomeration



### > Agglomeration Advantages

- **Labour pooling:** The concentration of industrial activities in a specific location leads to an optimal balance between supply & demand in the labour market.
- **Intermediate inputs:** The abundance of suppliers of specialized input & services enhance specialisation.
- **Technological spillovers:** Agglomeration of firms with similar products creates the development of technological knowledge.



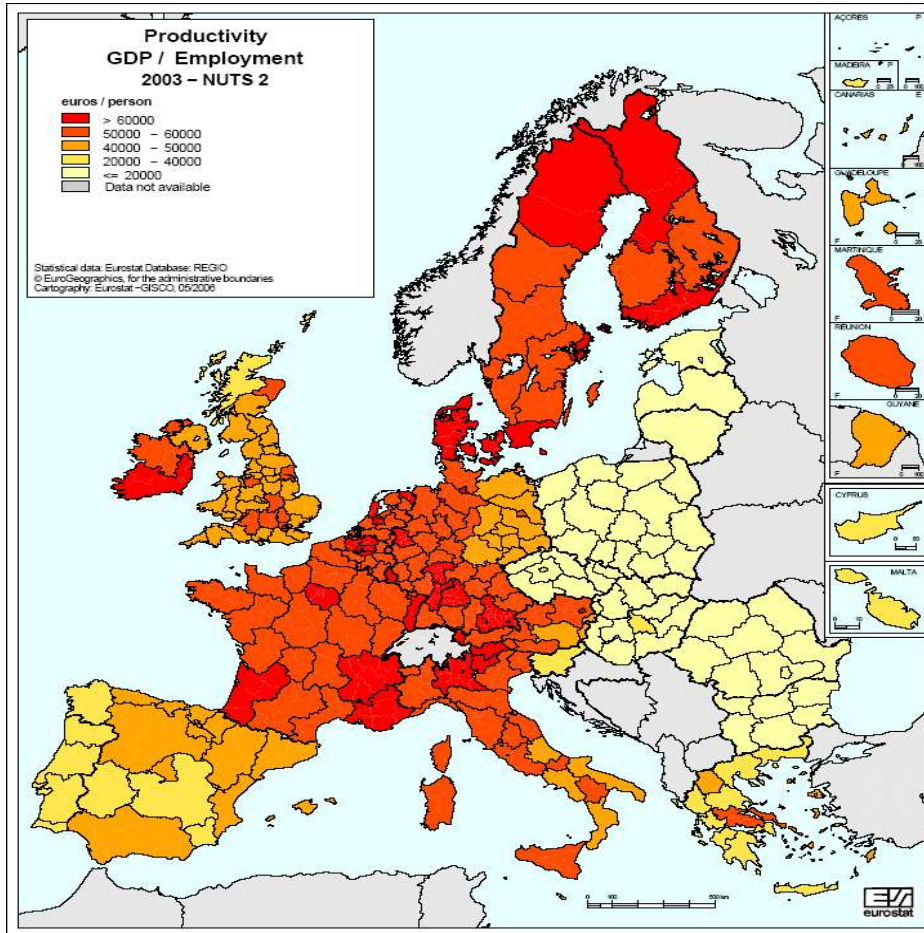
Source: [www.automobil-cluster.at](http://www.automobil-cluster.at)



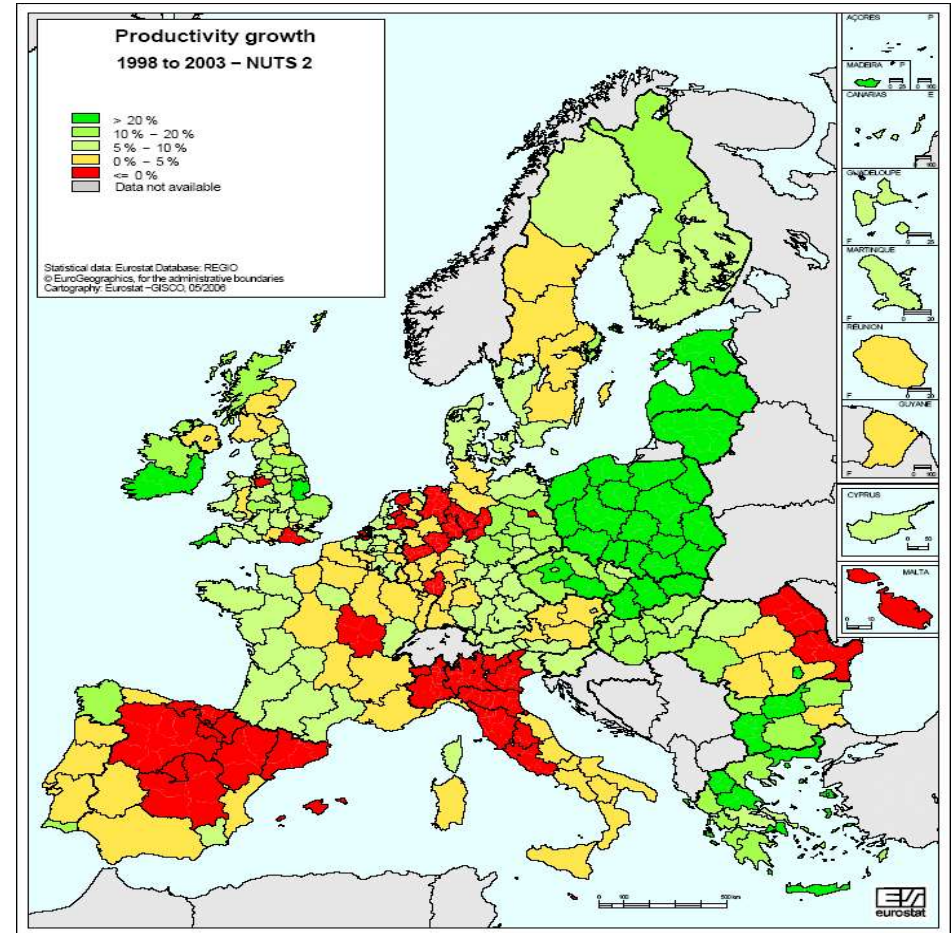
# MNC-Based Theoretical Framework



## ■ Labor Productivity



## ■ Labor Productivity Growth



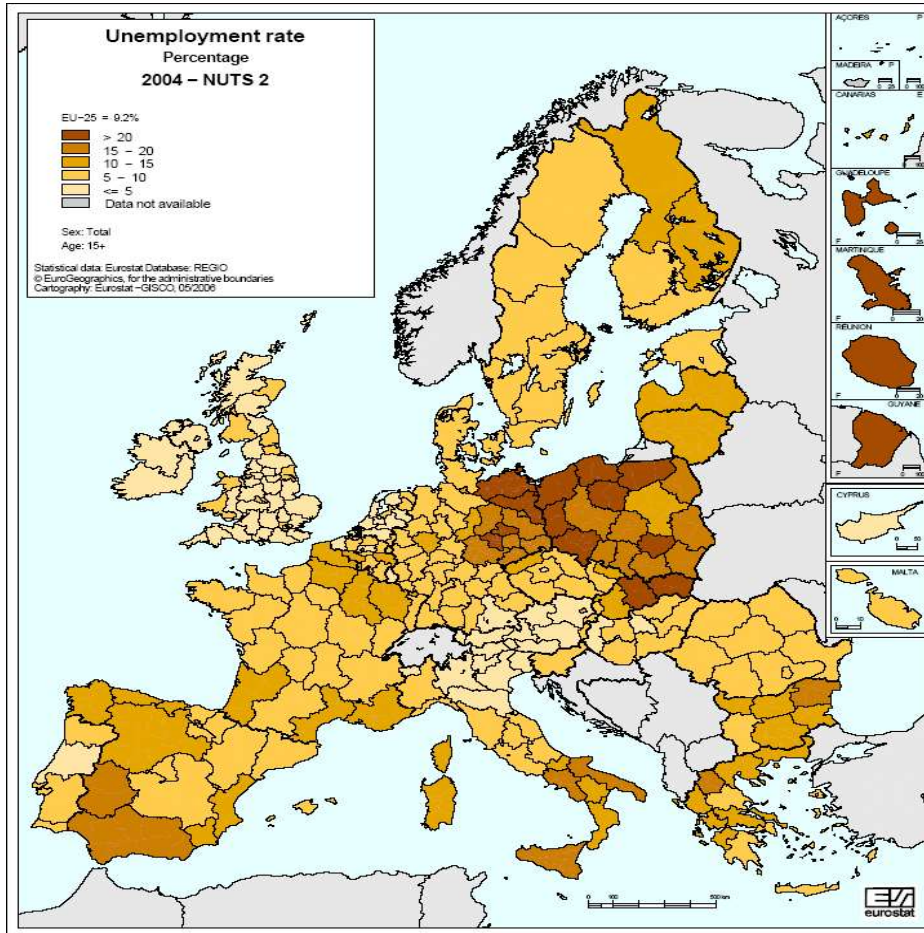
Source: Eurostat.



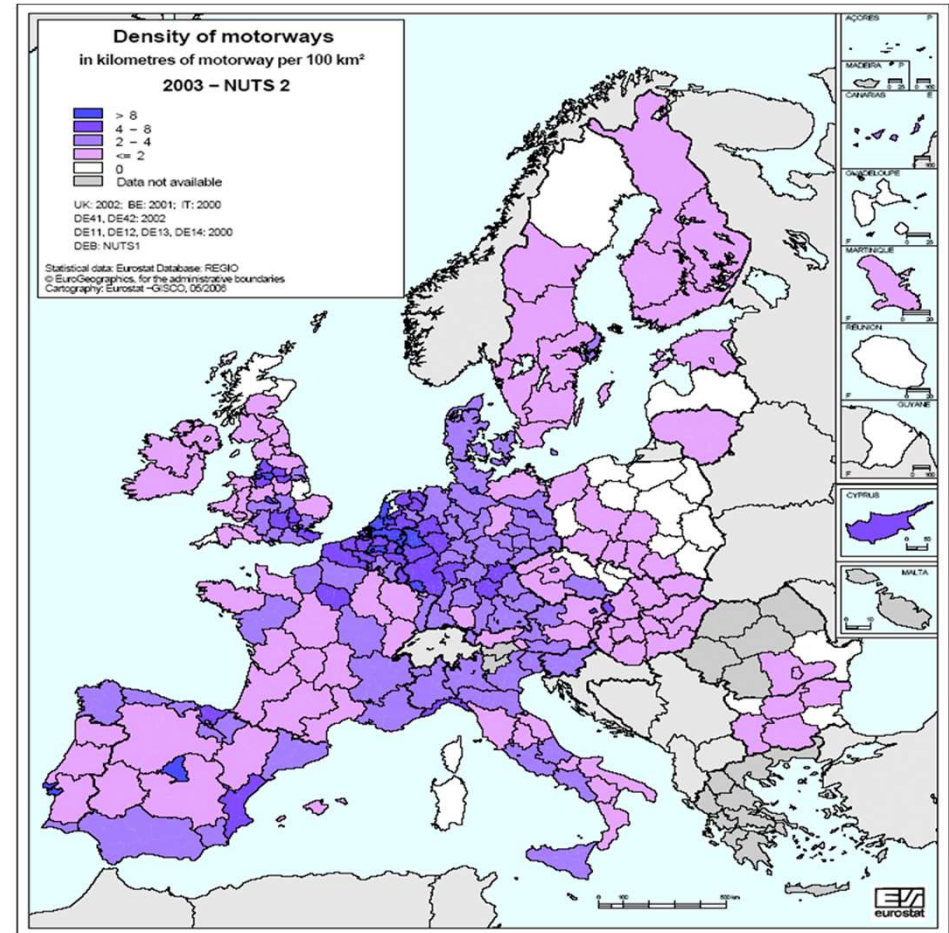
# MNC-Based Theoretical Framework



## ■ Unemployment Rates



## ■ Quality of Highways

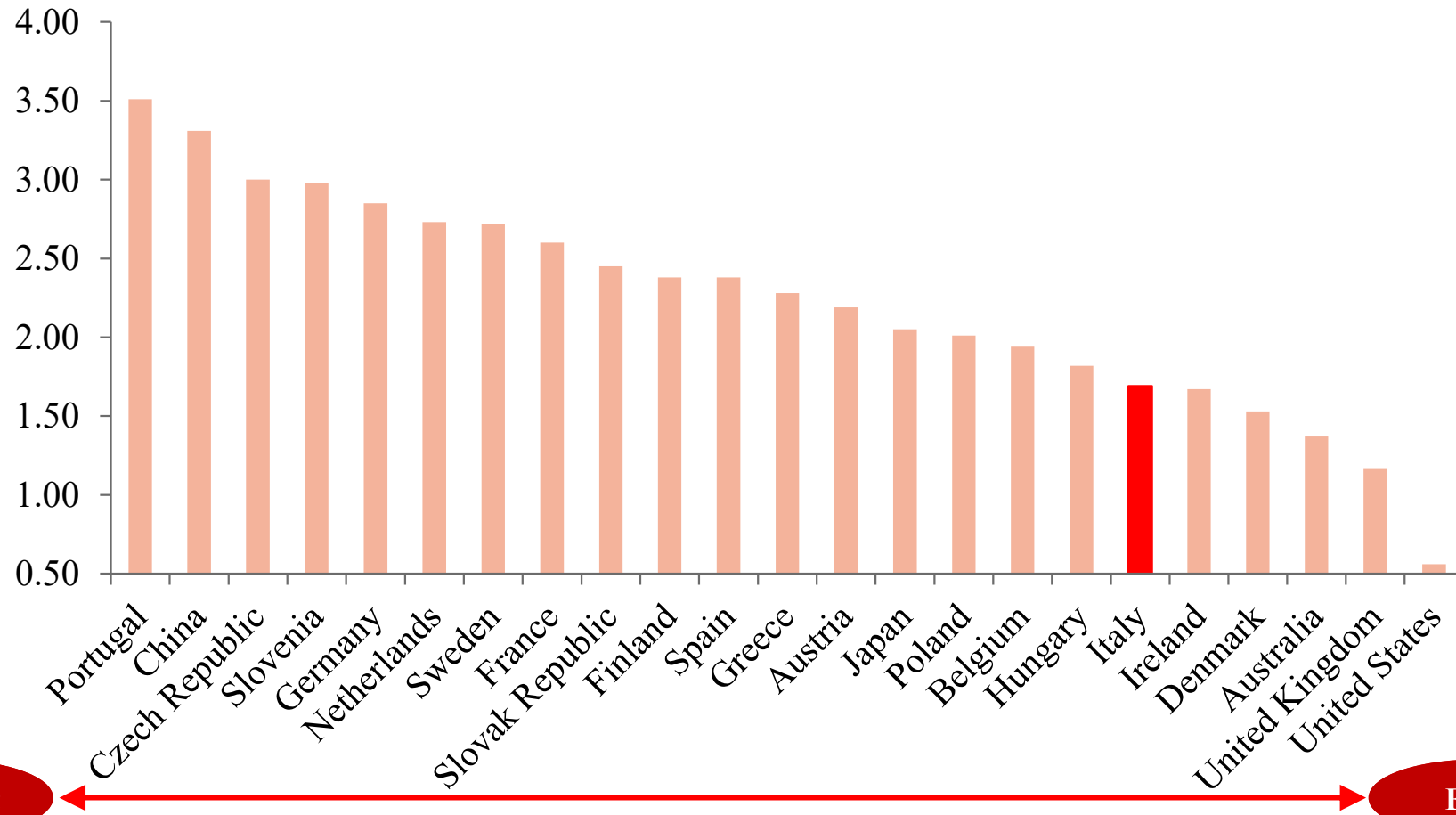


Source: Eurostat.

# MNE-Based Theoretical Framework



## ■ Easy or Difficult to Fire Employees?



Source: OECD Indicators of Employment Protection.

# MNE-Based Theoretical Framework



## ■ OLI Paradigm: 1 O-Advantages 2 L-Advantages 3 I-Advantages

### ASSET SPECIFICITY

- > **FDI** *versus* exports.
- > **FDI** *versus* outsourcing.

### DISSEMINATION RISK

- > **FDI** *versus* licensing of technology (e.g., automotive companies).

### STRATEGIC CONTROL

- > **FDI** *versus* licensing as market entry strategy
  - Starbucks in South Korea: Licencing to ESCO => **FDI** to promote the aggressive growth of the chain.

### INFORMATION ASYMMETRY

- > **FDI** *versus* exports where assessing the quality of the good is difficult.
- > **FDI** *versus* outsourcing where monitoring of the actual process is crucial.

### TACIT KNOWLEDGE TRANSFERS

- > **FDI** *versus* licensing/franchising of complex knowledge (e.g., OEM companies).

**I**nternalization advantages

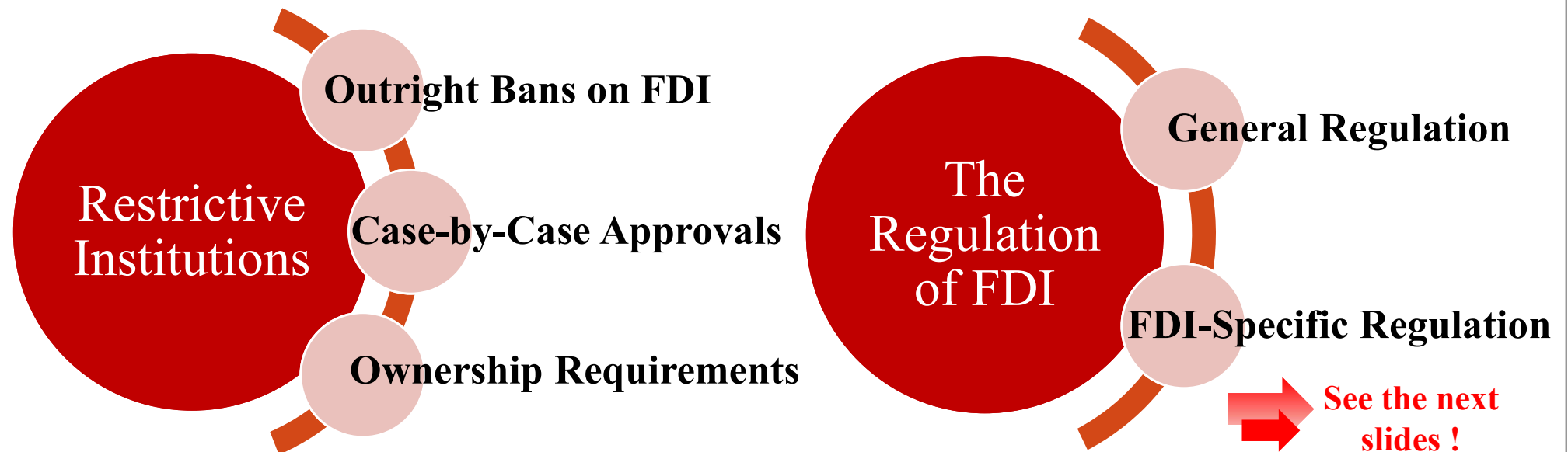


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## ■ Host Country Institutions

- ❖ The establishment of FDI is determined by firms' desire to exploit or develop their resources.
- ❖ **However (!)**, these decisions are still influenced by **a range of institutions** that have been made by both host & home countries.







## ■ Restrictive Institutions Come in '3' Forms:



### > Outright Bans on FDI

- **Complete bans on FDI** were common in LDCs.
- In the past, governments hostile to FDI have nationalized MNE assets (e.g., The **nationalization** of the oil industry in Venezuela).



### > Case-by-Case Approvals of FDI

- ... serve as a substitute for outright bans on FDI.
- Every FDI subject to **a registration & approval process**.
- These procedures are common in **emerging economies** (e.g., China) at early stages of their economic opening.



### > Ownership Requirements

- ... restrict full foreign ownership.
- In Vietnam, **no acquisitions** of local firms **until 2001**.
- The USA does not allow foreign majority ownership in **a domestic air transportation sector**.



## ■ The Regulation of FDI Comes in '2' Parts:



### > General Regulatory Institutions of Business:

- The operations of a foreign investor are subject to the host country's institutional framework, which may be quite different than what the investor is used to at home.
- **Restrictions** on **advertising** or the **pricing of utilities**.



### > FDI-Specific Regulation:

- Some countries make the operation of FDI subject to specific regulation.
- **Local content requirements** & **voluntary export restraints**.

## ■ Home Country Institutions

- ❖ Some governments consider **MNEs as vital to achieving national economic goals** (e.g., the J-government in the 1960s).





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# Benefits & Costs of FDI for Host Countries

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**Q. Do you think that foreign direct investments (FDIs) yield positive or negative effects on the local economy? If yes, HOW?**

# Benefits & Costs of FDI for Host Countries



	+ BENEFITS	COSTS -
<b>1</b> Consumers	Access to international <b>quality products &amp; brands, lower prices.</b>	Reduces variety of traditional local brands ( <b>Decreased product variety</b> )
<b>2</b> Suppliers	<b>Technology transfer</b> enhancing productivity, be global/international.	<b>Crowding out</b> by international sourcing.
<b>3</b> Competitors	Technology spillovers => learning Competition => <b>innovation.</b>	<b>Crowding out</b> by overwhelming competition.
<b>4</b> Workers	<b>Employment</b> opportunities. Higher labor standards, training.	Less labor intensive production ( <i>i.e.</i> , <b>less work places</b> ) than local firms
<b>5</b> Government	<b>Tax revenues.</b> Economic growth.	<b>Costs</b> of subsidies & other incentives.
<b>6</b> Environment	MNEs often have <b>higher environmental standards.</b>	<b>Polluting activities</b> in places with less stringent regulation.

# Benefits & Costs of FDI for Host Countries



## ■ Multinational Corporations: Good or Bad?

	Positive (+)	Negative (-)
Enterprise Level	<ul style="list-style-type: none"><li>– Increased labor productivity.</li><li>– Access to worldwide sale &amp; distribution networks.</li><li>– Transfer of Western technology &amp; know-how.</li><li>– Improved effectiveness.</li></ul>	<ul style="list-style-type: none"><li>– Divestment &amp; downsizing of production (<u>particularly, in times of crisis</u>).</li></ul>
Local Economy	<ul style="list-style-type: none"><li>– Creation of new jobs.</li><li>– Increased wages.</li><li>– Increased tax base.</li><li>– Increased exports.</li><li>– Labor training.</li><li>– Social services to local societies.</li></ul>	<ul style="list-style-type: none"><li>– Instability of foreign investment.</li><li>– Suppression of the development of new indigenous enterprises.</li><li>– Attracting skilled &amp; semi-skilled workers from indigenous firms.</li></ul>

**Source:** Pavlinek , P. (2004: 48). “Regional Development Implications of Foreign Direct Investment in Central Europe”, *European Urban & Regional Studies*, 11(1): 47-70.

# Benefits & Costs of FDI for Host Countries



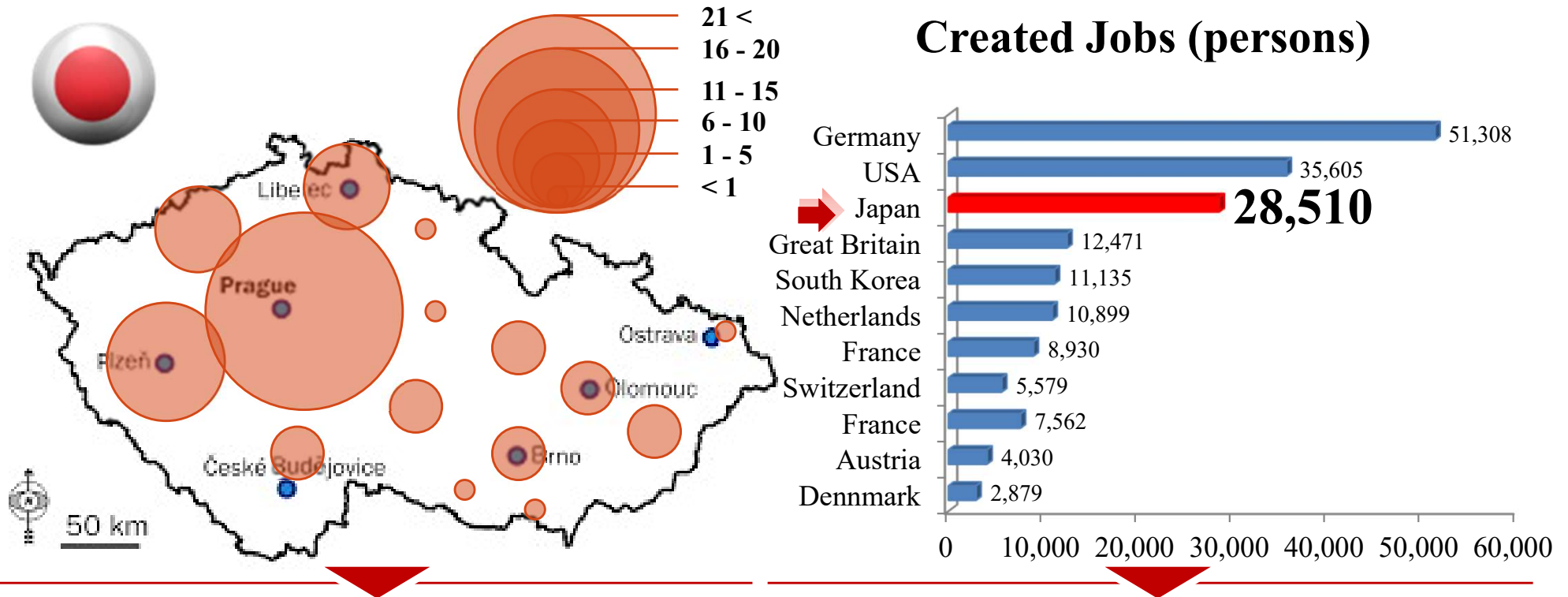
## ■ My Talk at the Presidential Office of the Czech Republic



# Benefits & Costs of FDI for Host Countries



## Geography & Job Creation of Japanese MNCs



❖ Japanese production activities have been **very active**, particularly, in Central Bohemia, Ústí nad Labem, Plzeň & South Moravia.

❖ Japan is ranked 3rd in terms of the creation of employment opportunities for local people.

Source: Own illustration based on various sources.

# Benefits & Costs of FDI for Host Countries

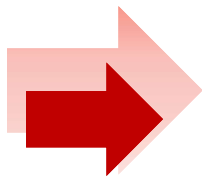
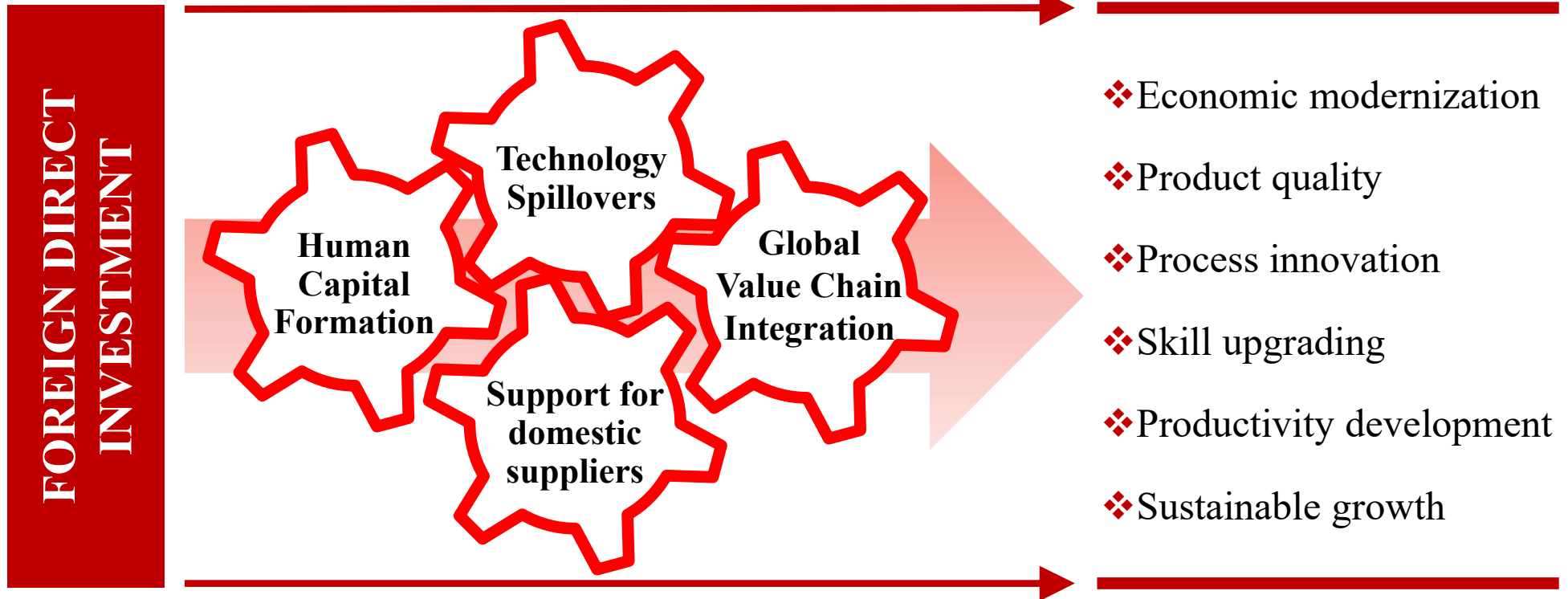


## Disentangling the Consequences of FDI



### POTENTIAL CONTRIBUTIONS

### CONSEQUENCES



**SURVEY** (March 2015)

5 Japanese manufacturing companies (Automotive, Electric components)

Average size: 1,033.2 employees | Average age: 14.8 years | Coding: J-1, J-2, J-3, J-4 & J-5



# Benefits & Costs of FDI for Host Countries



## ■ Disentangling the Consequences of FDI

### ▶ Human Capital Formation

Knowledge Transfer

Support for Domestic Suppliers

Global Value Chain Integration

### 1 On-The-Job Training

- > Training sessions to update skills & abilities of existing workers (J-2).
- > Establishment of an **in-house training center** (J-3).
- > **Technical support** from experienced workers to freshman workers (J-4).

### 2 Fostering of Human Resources

- > “**Working in Japan**” scheme & training sessions in mother factories when new equipment & new products are launched (J-1); VAVE & Auto CAD seminars (J-4).
- > **Customized trainings sessions** based on occupational category & level (J-2).
- > **Management of personal training history** (J-2).

### 3 Quality Control Circle

- > 4 surveyed firms emphasized the importance of improving a **participatory management system** where employees are proactive in solving problems related to their own jobs (J-1, J-2, J-4, J-5).
- > Participation in **QC Circle Competition** (J-1, J-2).

Source: Own interviews.



## ■ Disentangling the Consequences of FDI

Human Capital  
Formation

▶ Knowledge  
Transfer

Support for  
Domestic  
Suppliers

Global Value  
Chain  
Integration

### 1 Introduction of Production Equipment

- > Own development after the **transfer of production equipment** from mother factories in Japan (**J-1**).
- > **Local sourcing of productive facilities & equipment** (The localization level of production equipment for automobile part reaches  $\approx 40\%$  in terms of cost.) (**J-4**).

### 2 Production Methods

- > Promotion of **system development** in response to **local needs** (**J-1**).
- > Development & installation of **production control systems** based on the own **e-factory system** (**J-4**).
- > Execution of a **Kanban system** (**J-3**) & a **process management system** (**J-5**).

### 3 Managerial Skills

- > **Visualization of production status & financial outcomes** (**J-3**).
- > **Transfer of managerial know-how from the HQs** in terms of board meetings, financial management, confidential information management system & HR management (**J-4**).
- > **Alpha systems** (**J-5**) & **SAP systems** (**J-2, J-5**).

Source: Own interviews.

# Benefits & Costs of FDI for Host Countries



## Disentangling the Consequences of FDI

Human Capital Formation

J-1

- ❖ Advice on **equipment & operations**.
- ❖ Solutions to specific technical problems.

J-2

- ❖ Provision of **tools**
- ❖ Advice on **quality improvement**
- ❖ Regular **quality audits**.

J-3

- ❖ **Technical assistance** regarding **timely delivery & quality control**.

Knowledge Transfer



Support for Domestic Suppliers

Global Value Chain Integration

- ❖ Advice on **process methods**
- ❖ **Quality audits** (e.g., Motor Jikov Slevarna a.s., TESLA Jihlava s.r.o., BELIS s.r.o., etc.).

J-4

- ❖ **Technical instruction** aimed to reduce the plastic molding time.
- ❖ Guidance for **cost improvement** to local metal sheet producers.

J-5

# Benefits & Costs of FDI for Host Countries



## Disentangling the Consequences of FDI

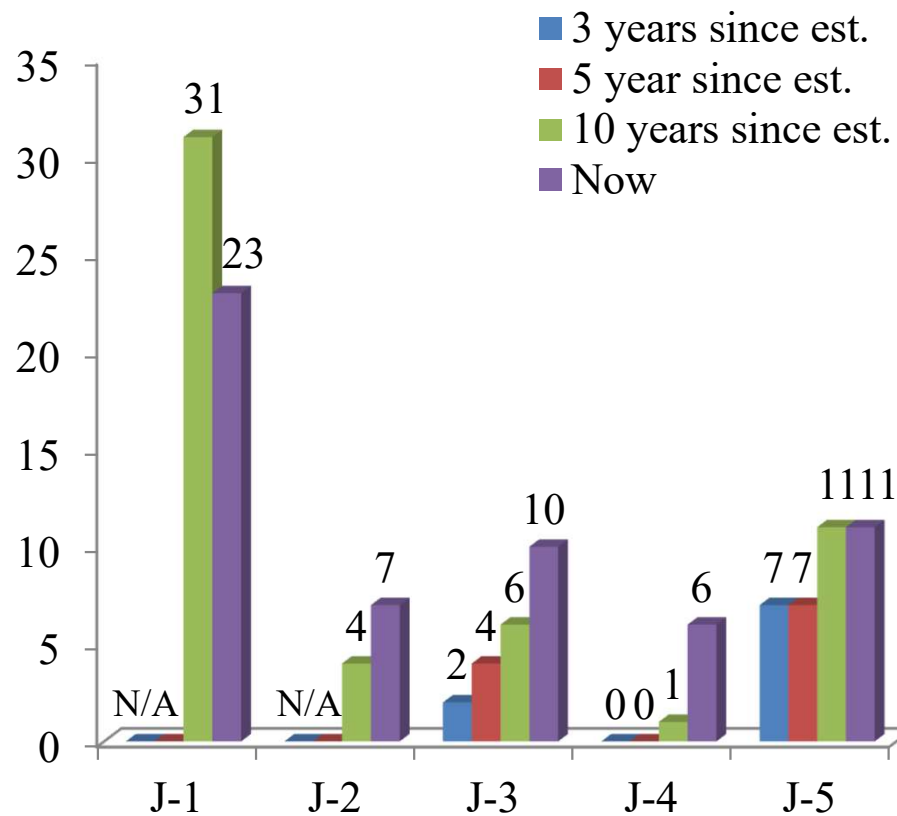
Human Capital Formation

Knowledge Transfer

Support for Domestic Suppliers

Global Value Chain Integration

Number of Czech Suppliers by J-Firms



% of the global value chain network

J-1

8.7%

J-2

100%

J-3

0.0%

J-4

0.0%

J-5

9.1%

Source: Own interviews.

# Benefits & Costs of FDI for Host Countries



## ■ Does the Sun Rise Higher?

- ❖ J-MNCs are competitive in the **manufacture of capital goods & intermediate goods**.
- ❖ Many J-MNCs have been successful in penetrating global markets & **securing very high market share**.
- ❖ A source of competitive strength for Japan is **innovativeness**.
- ❖ **Rising pressures from their Korean & Chinese counterparts**.

## ■ Contributions to the Upgrading of the Host Nation

- ❖ J-MNCs are very **stable & sustainable** investors.
- ❖ J-investors' **positive effects** in the Czech Republic:
  - (1) Job creation; (2) knowledge spillover; (3) human capital accumulation; & (4) backward linkage formation.
  - **“Cathedrals in the desert”?!**

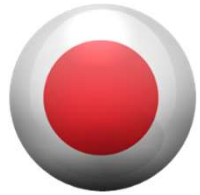


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# Internationalization of Asian Firms



## Japanese Outward FDI in Europe (Unit: US\$ Millions)





# Internationalization of Asian Firms



## Chinese Outward FDI in Europe (Unit: US\$ Millions)





## ■ The Determinants of Chinese Outward FDI (Buckley et al., 2007)

### Explanatory Factors

### Dependent Variable

#### 1 Capital Market Imperfections

- > Soft budget constraints;
- > Subsidies; &
- > Cheap capital from family members.

#### 2 Ownership Advantages

- > Networking skills;
- > Market information; &
- > Relational assets.

#### 3 Institutional Factors

- > High levels of government support;
- > Export tax rebates; &
- > Foreign exchange assistance.

Chinese Outward FDI

#### Empirical Results

- ✓ Market-seeking (GDP);
- ✓ Transaction costs (Political stability, cultural proximity & ethnic networks); &
- ✓ Institutional factors (Trade liberalization).



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## ■ What Should Managers Care About?



- Assess whether FDI is justified in terms of other foreign entry modes (e.g., **outsourcing & licensing**).
  - > **Internalization advantages** are deemed not crucial, then **FDI** is not recommended.



- Pay careful attention to the location advantages in combination with **the firm's strategic goals**.
  - > Location, Location, Location !
  - > Compatibility between **strategy & location**.



- Be aware of the **institutional constraints & enablers** governing FDI & enhance legitimacy in host countries.
  - > MNC managers **should not take** FDI-friendly policies **for granted**. Setbacks are likely.

# The End of Today's Lecture



ご清聴有難う御座いました。

**Thank you so much!**

**Vielen Dank für Ihre Aufmerksamkeit!**

**Grazie mille !**

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