

Investing Abroad Directly
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Special Topics in Internationalization

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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. MNE-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 MNEs



- > 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.



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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

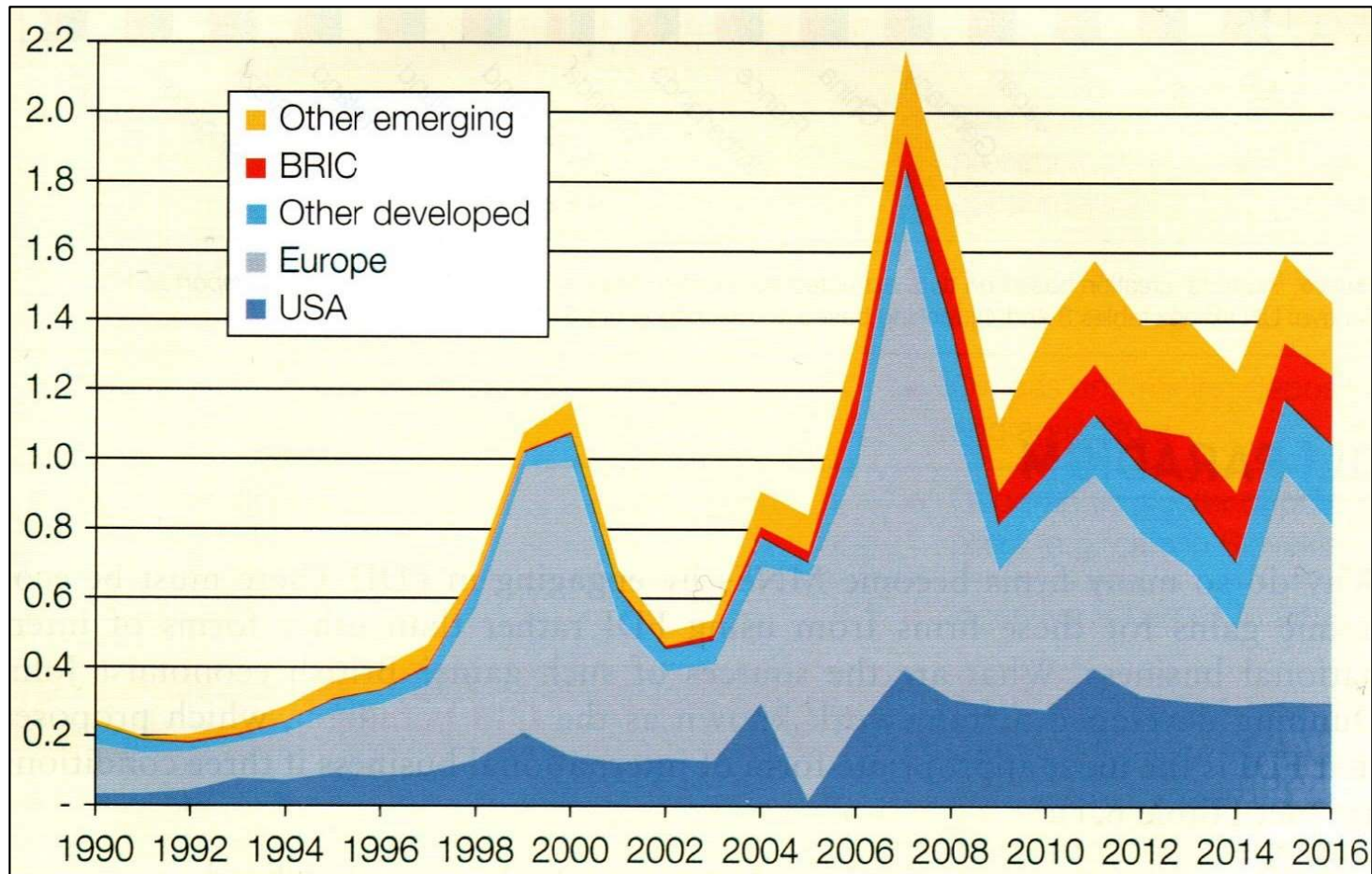


Upstream
vertical FDI

Downstream
vertical FDI



■ FDI Outflows (US\$ Trillion)



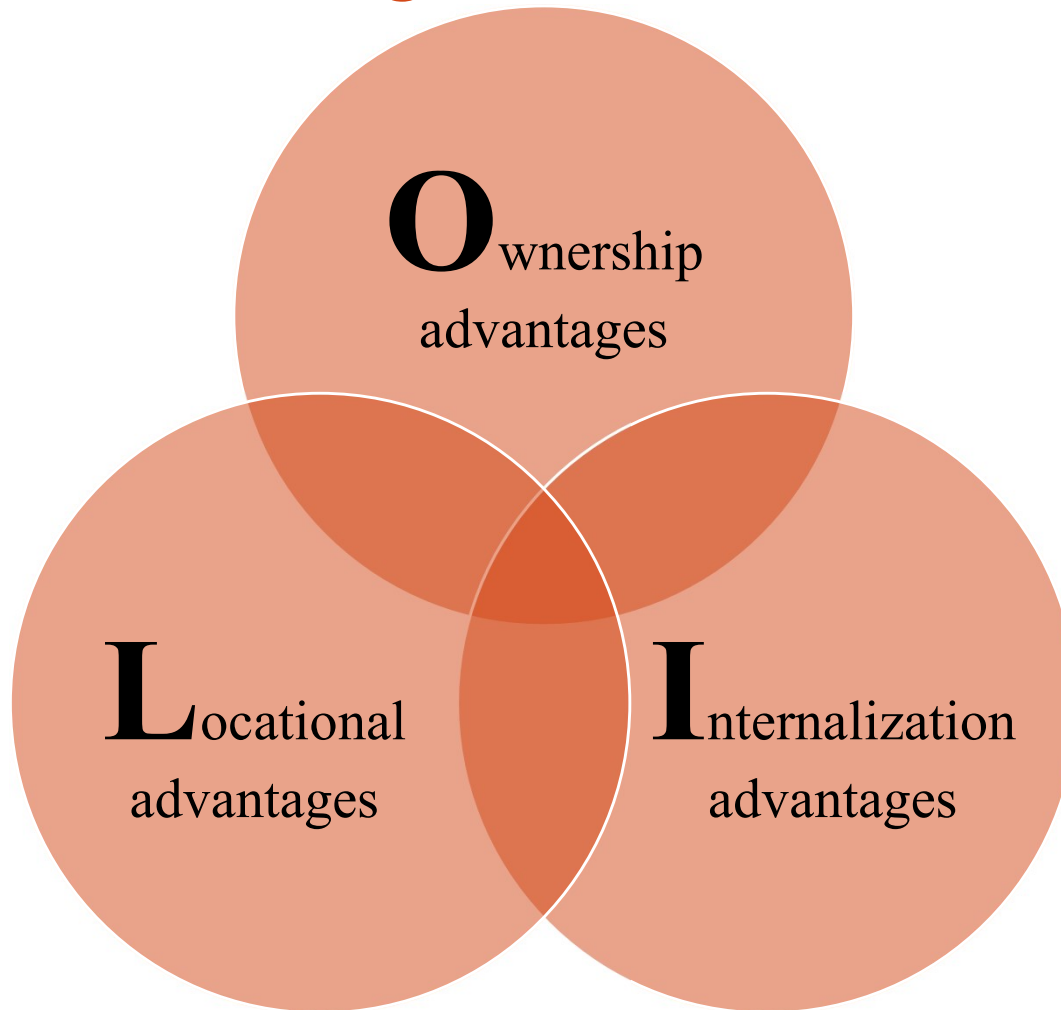
Source: Peng & Meyer (2019: 155).



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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.

MNE-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.



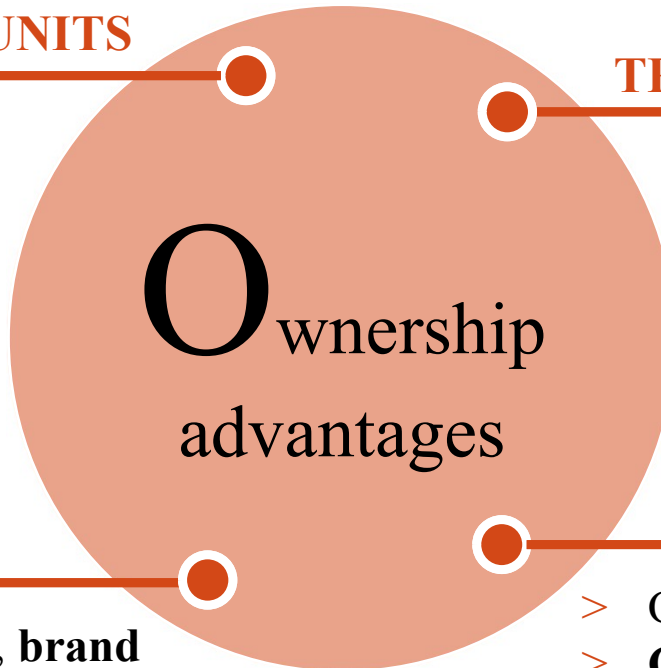
TRANSFERABLE RESOURCES

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



ORGANIZATIONAL STRUCTURES & CULTURE

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



O-Advantages: Johnson & Johnson



■ 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!”

MNE-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

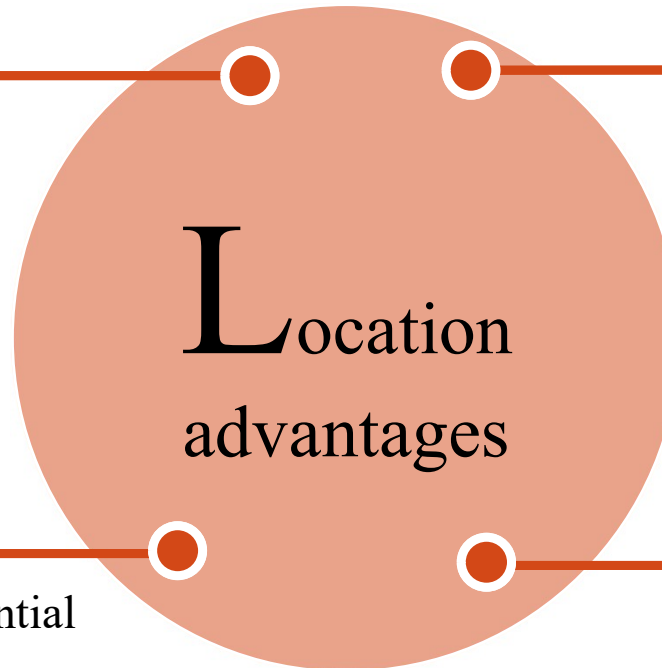
- > **FDI incentives:**
 - Corporate tax reduction.
 - Tax exemption.
 - Grants.
 - Investment promotion agencies.

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.



MNE-Based Theoretical Framework

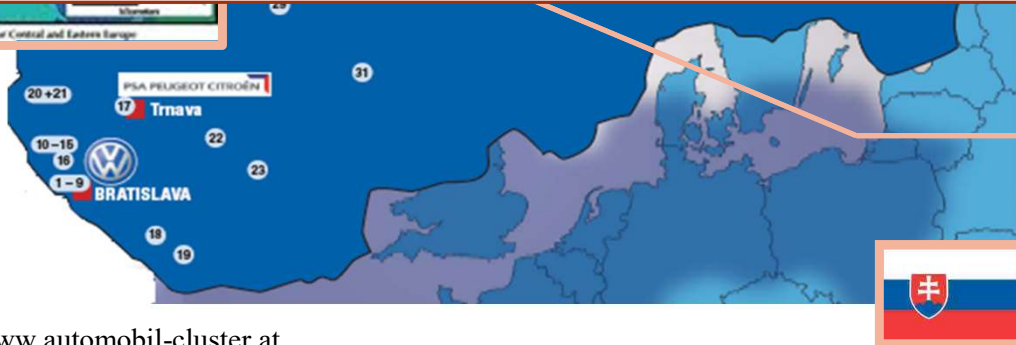


■ Agglomeration



> 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.

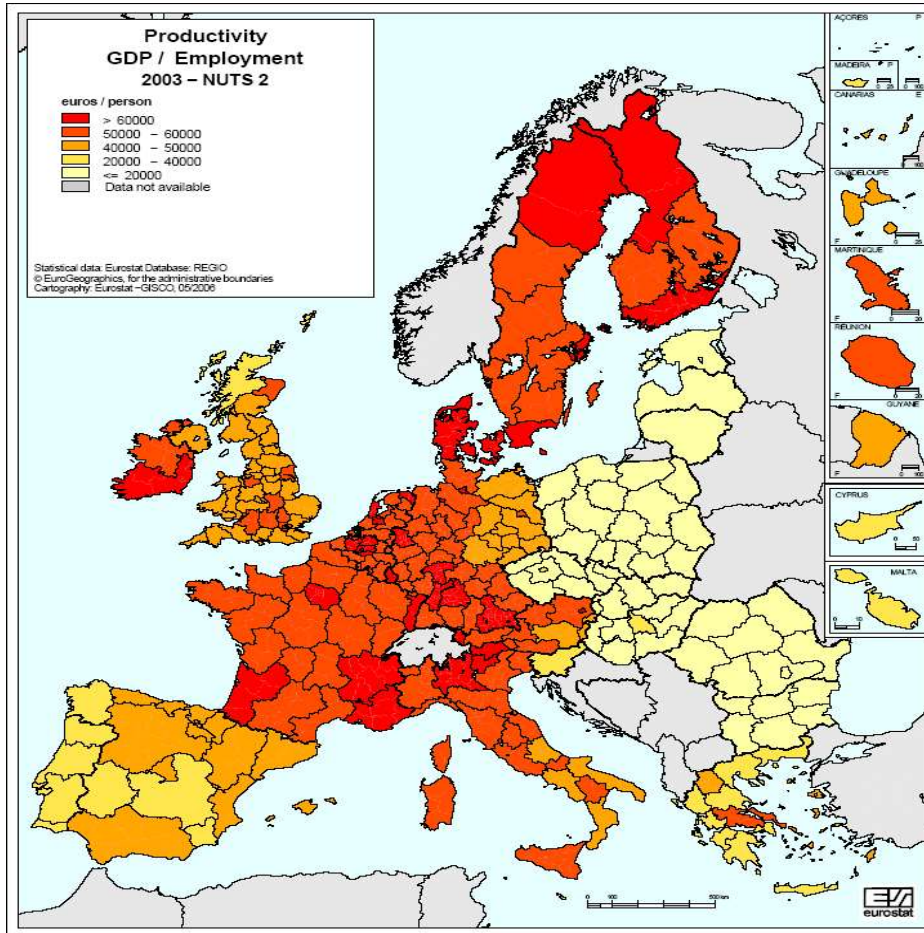


Source: www.automobil-cluster.at

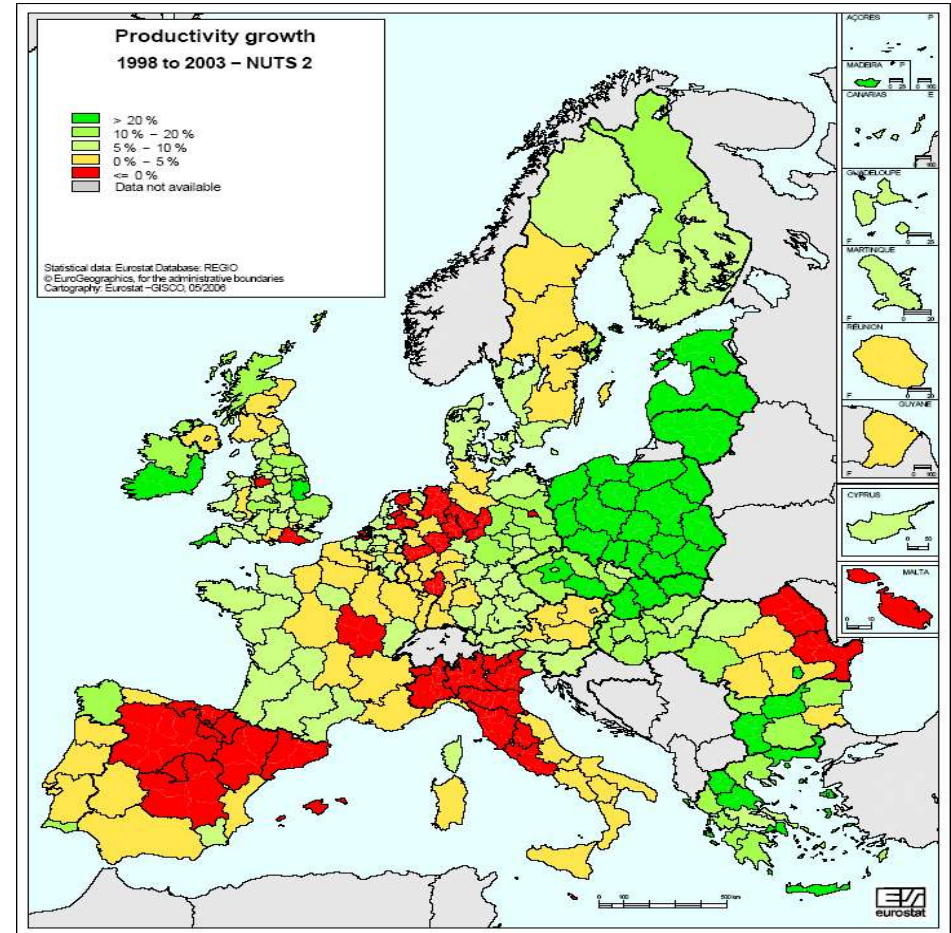
MNE-Based Theoretical Framework



■ Labor Productivity



■ Labor Productivity Growth

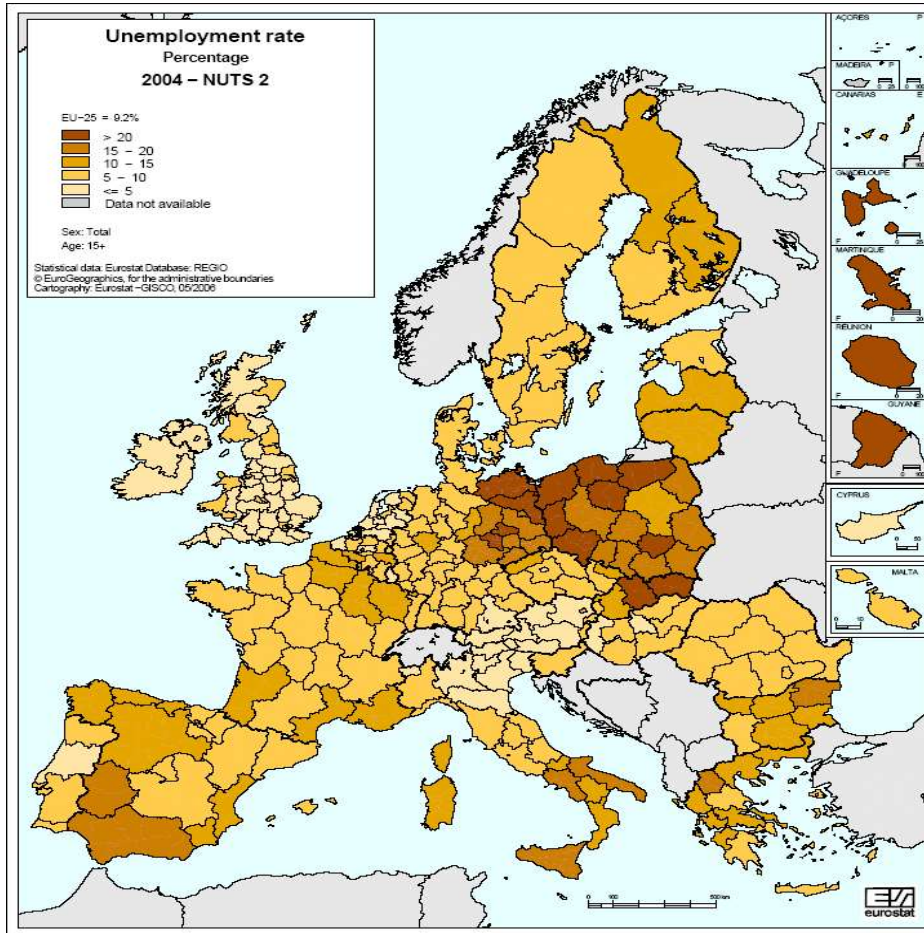


Source: Eurostat.

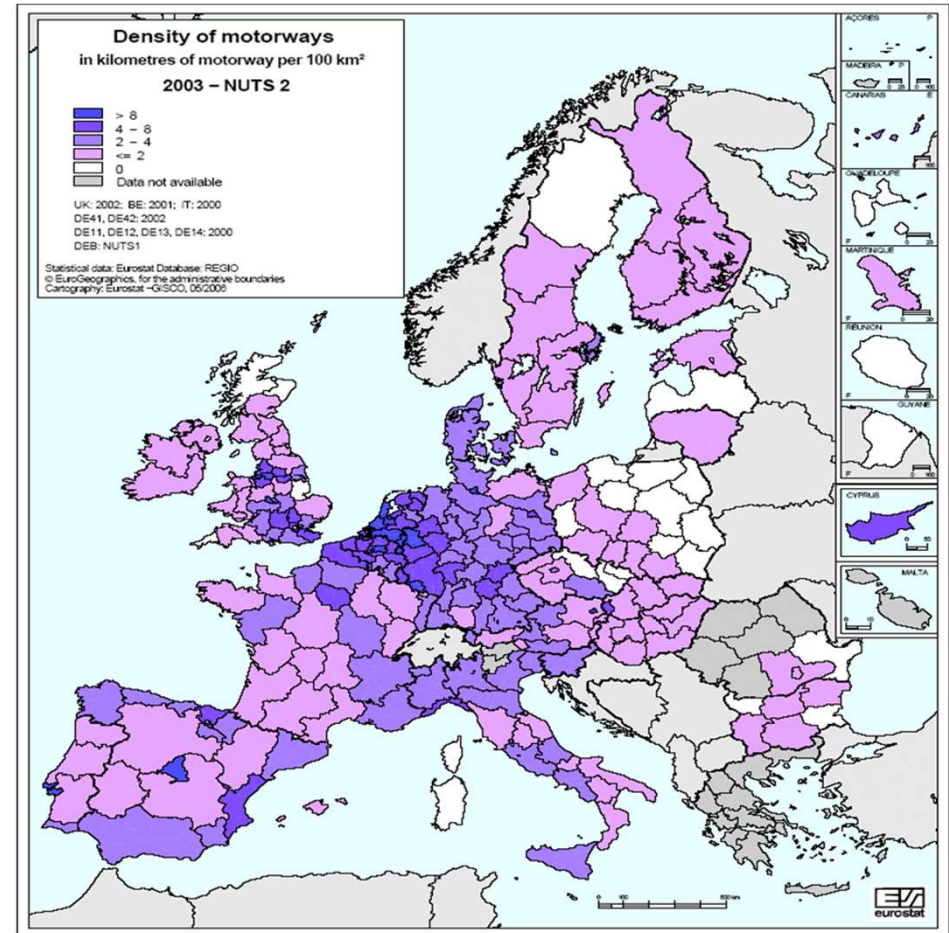
MNE-Based Theoretical Framework



■ Unemployment Rates



■ Quality of Highways

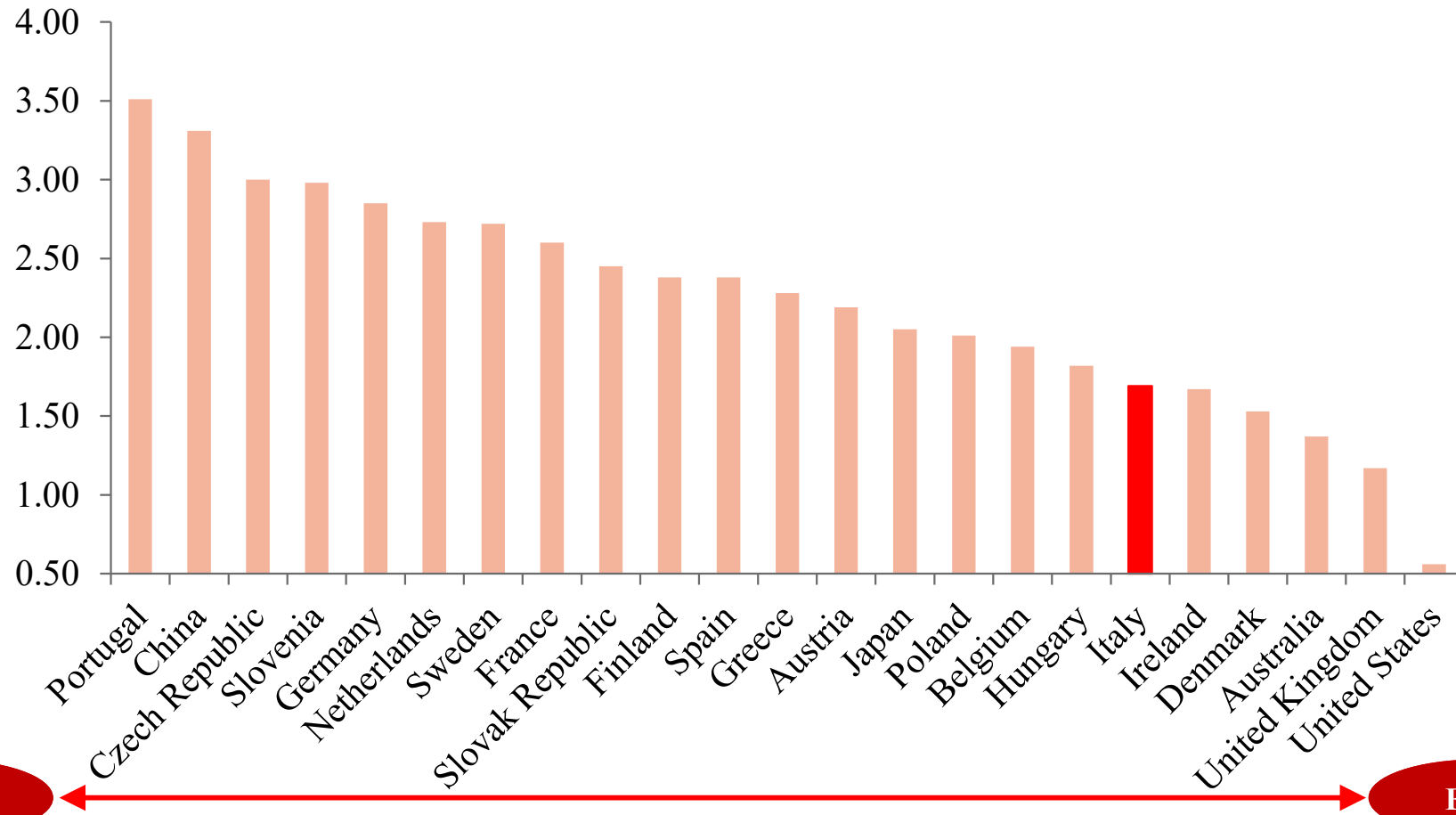


Source: Eurostat.

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).

Internalization advantages

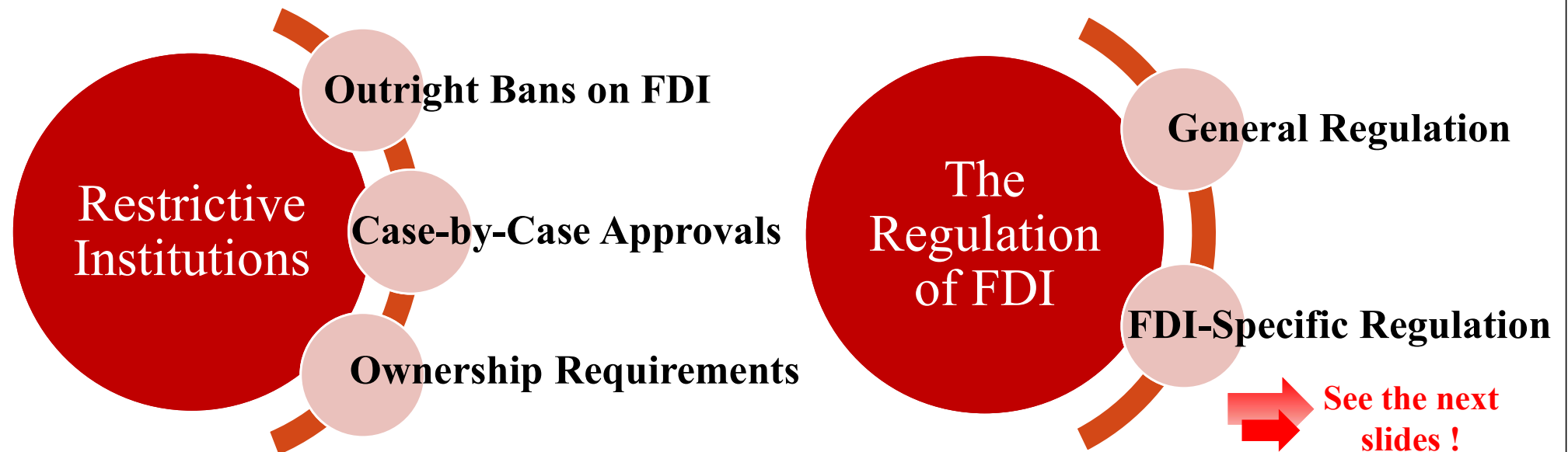


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■ Host Country Institutions

- ❖ 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:

1



> 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).

2



> 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.

3



> 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



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 -
1 Consumers	Access to international quality products & brands, lower prices.	Reduces variety of traditional local brands (Decreased product variety)
2 Suppliers	Technology transfer enhancing productivity, be global/international.	Crowding out by international sourcing.
3 Competitors	Technology spillovers => learning Competition => innovation.	Crowding out by overwhelming competition.
4 Workers	Employment opportunities. Higher labor standards, training.	Less labor intensive production (<i>i.e.</i> , less work places) than local firms
5 Government	Tax revenues. Economic growth.	Costs of subsidies & other incentives.
6 Environment	MNEs often have higher environmental standards.	Polluting activities 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">– Increased labor productivity.– Access to worldwide sale & distribution networks.– Transfer of Western technology & know-how.– Improved effectiveness.	<ul style="list-style-type: none">– Divestment & downsizing of production (particularly, in times of crisis).
Local Economy	<ul style="list-style-type: none">– Creation of new jobs.– Increased wages.– Increased tax base.– Increased exports.– Labor training.– Social services to local societies.	<ul style="list-style-type: none">– Instability of foreign investment.– Suppression of the development of new indigenous enterprises.– Attracting skilled & semi-skilled workers from indigenous firms.

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



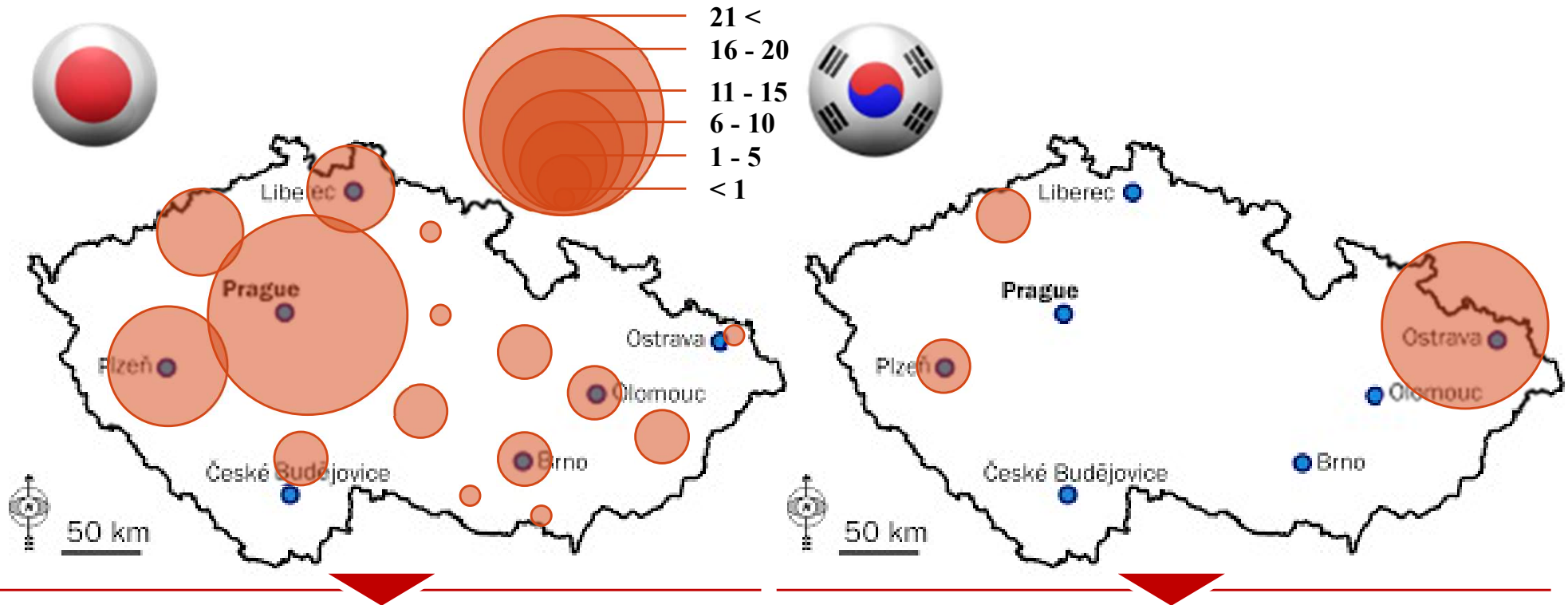
■ My Talk at the Presidential Office of the Czech Republic



Benefits & Costs of FDI for Host Countries



■ Geography of Japanese & Korean MNCs



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

❖ The geographical distribution of Korean production activities have been **uneven**.
❖ The Moravia-Silesia region accounts for $\approx 80\%$.

Source: Own illustration based on various sources.

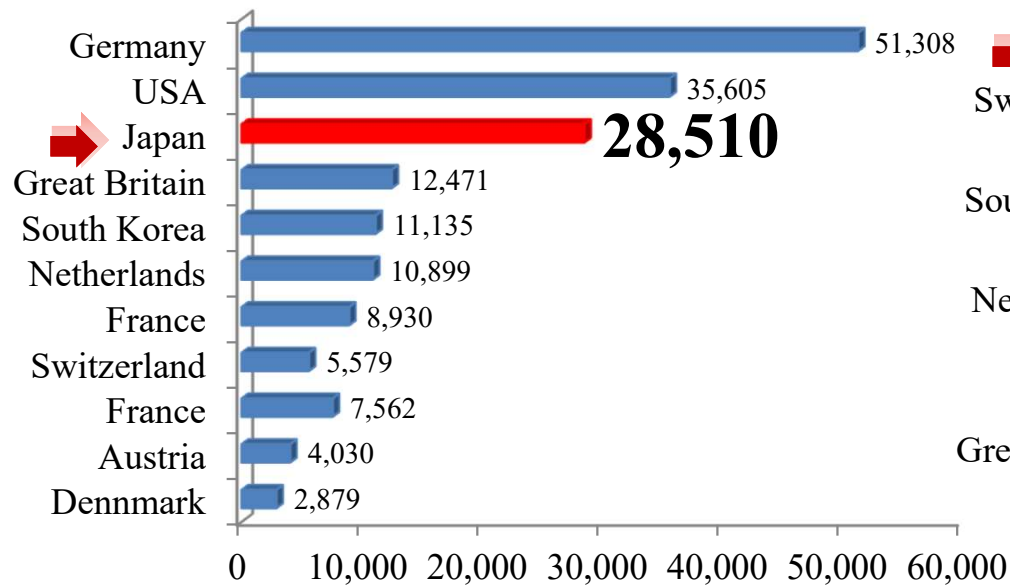
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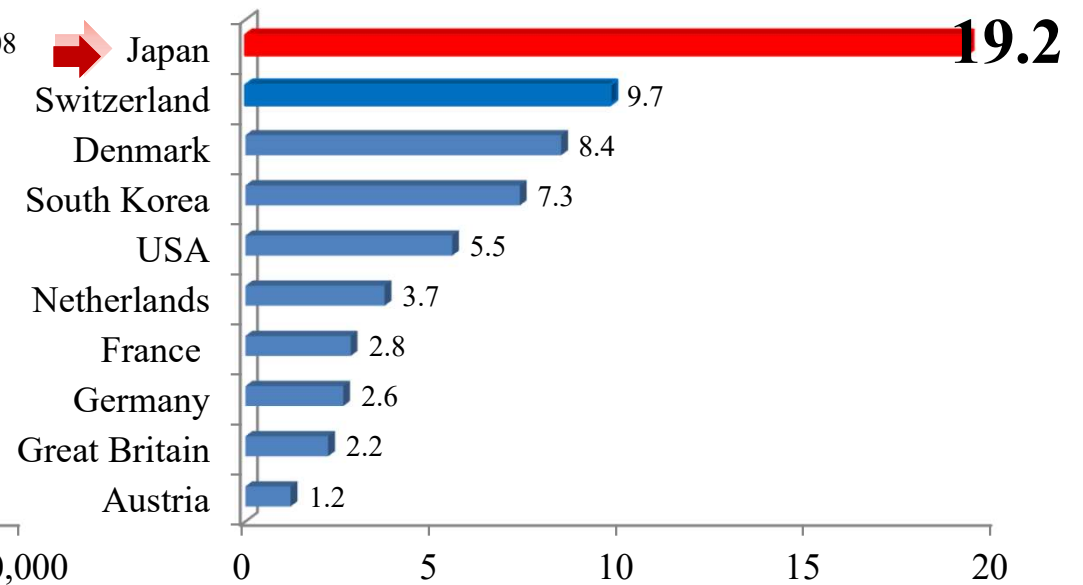
Job Creation



Created Jobs (persons)



Created Jobs per Citizen (persons)



❖ **Japan is ranked 3rd** in terms of the creation of employment opportunities for local people, but **Japan** achieves the **highest** number of new job opportunities per citizen.

Source: Own illustration based on various sources.

Benefits & Costs of FDI for Host Countries

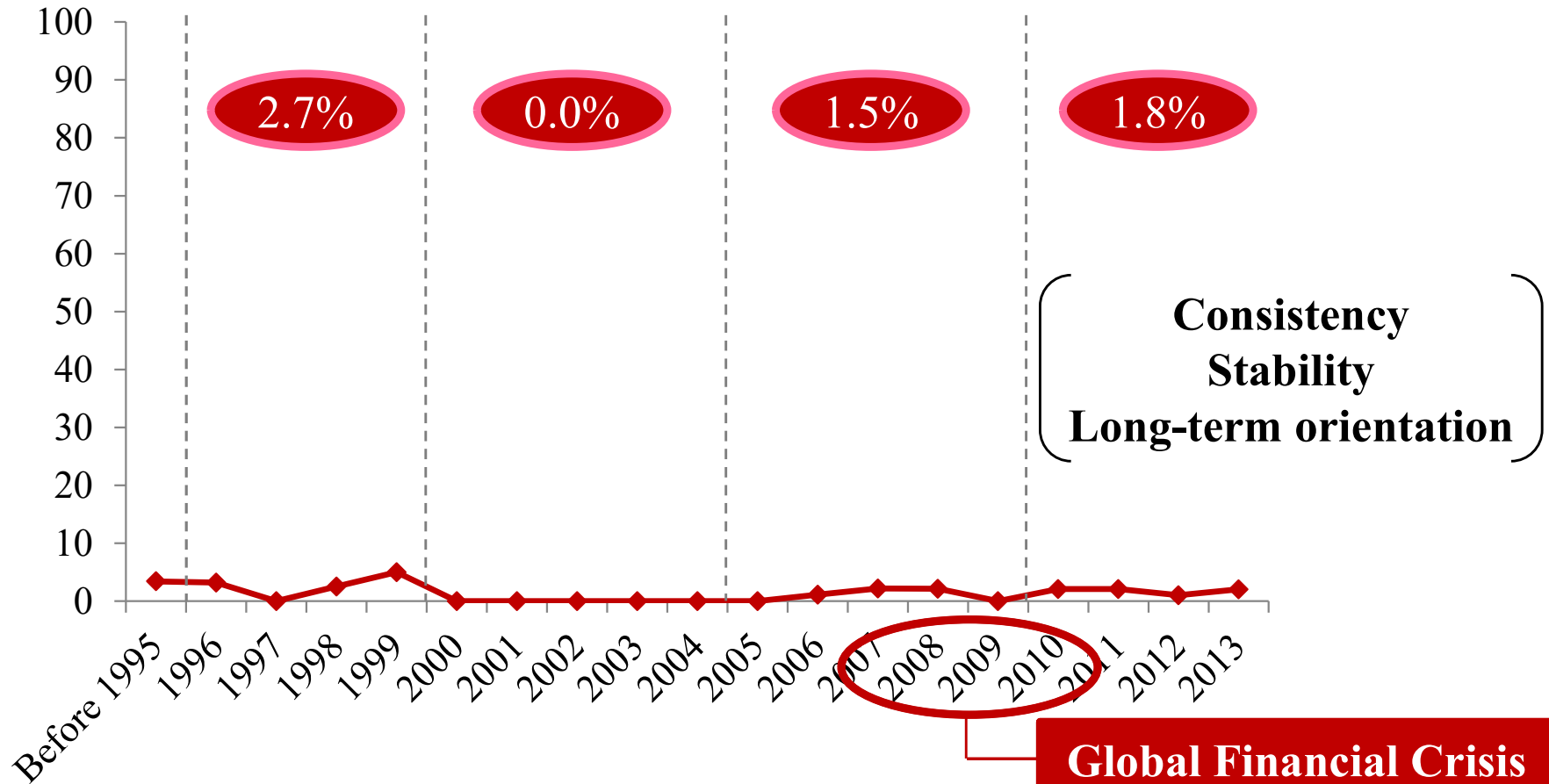


Market Exit Ratio



Exit ratio

= Number of affiliates leaving the country in year t / (number of affiliates appearing in year t + number of affiliates leaving the country in year t)

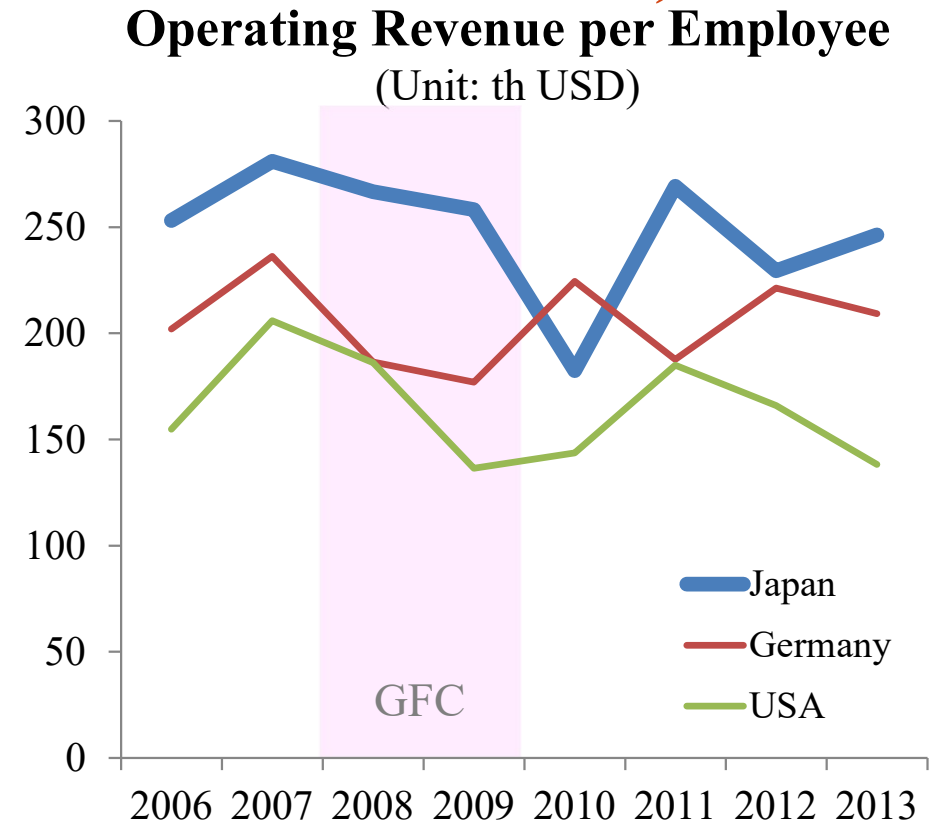
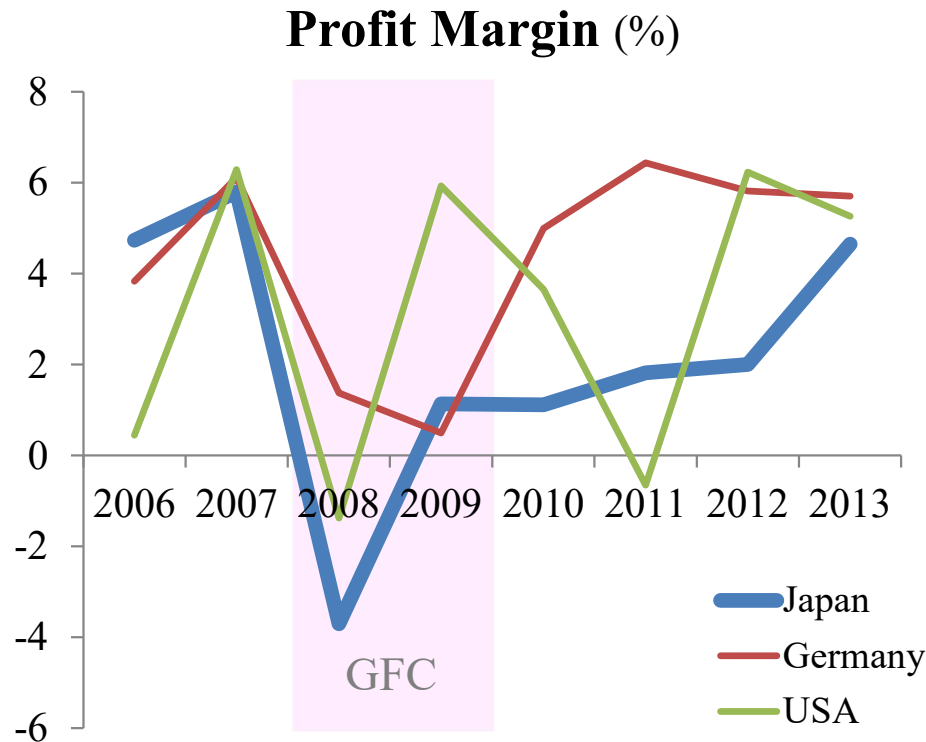


Source: Own illustration based on Toyo Keizai (2005, 2006, 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014).

Benefits & Costs of FDI for Host Countries



■ FDI Performance (Manufacture of Motor Vehicle)



❖ Labor productivity in J-MNCs is higher than in their Western counterparts.

Source: Own illustration based on Orbis.

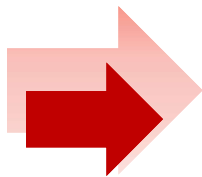
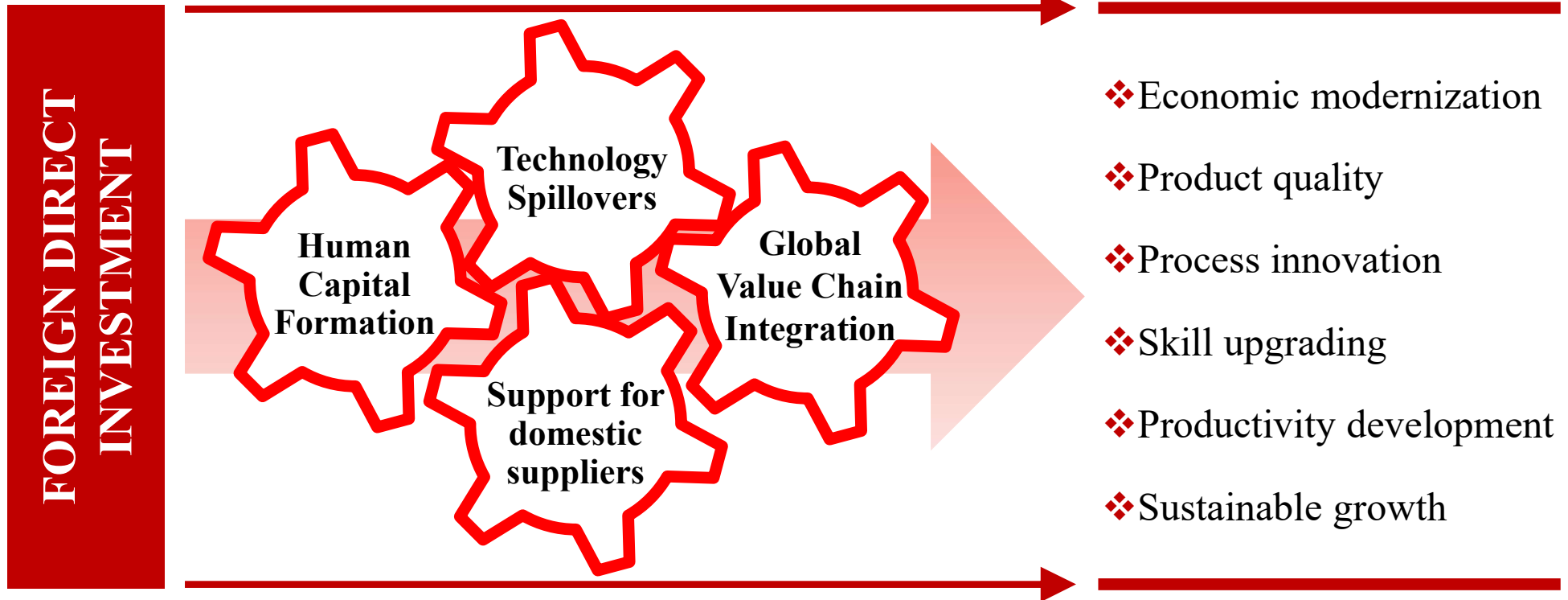
Benefits & Costs of FDI for Host Countries



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



■ Expatriates Facilitate Knowledge Transfer (2015; N=26)



Fully disagree

Fully agree

1 2 3 4 5 6 7

TECHNICAL SKILLS

- A. Our expatriates possess **superior technical skills**.
- B. Our expatriates possess **superior management knowledge**.

MOTIVATION

- A. Our expatriates **unreservedly** transfer knowledge to local employees.
- B. Our expatriates undertake great efforts to **develop successors** (namely, local employees).
- C. Our expatriates **delegate important tasks** to local employees.

ADAPTABILITY

- A. Our expatriates **adapt** knowledge transfer approaches to **local conditions**.
- B. Our expatriates are **skillful in teaching knowledge** to local employees.

Fully disagree

Fully agree

Source: Own survey (2015).

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

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**.



- ❖ 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

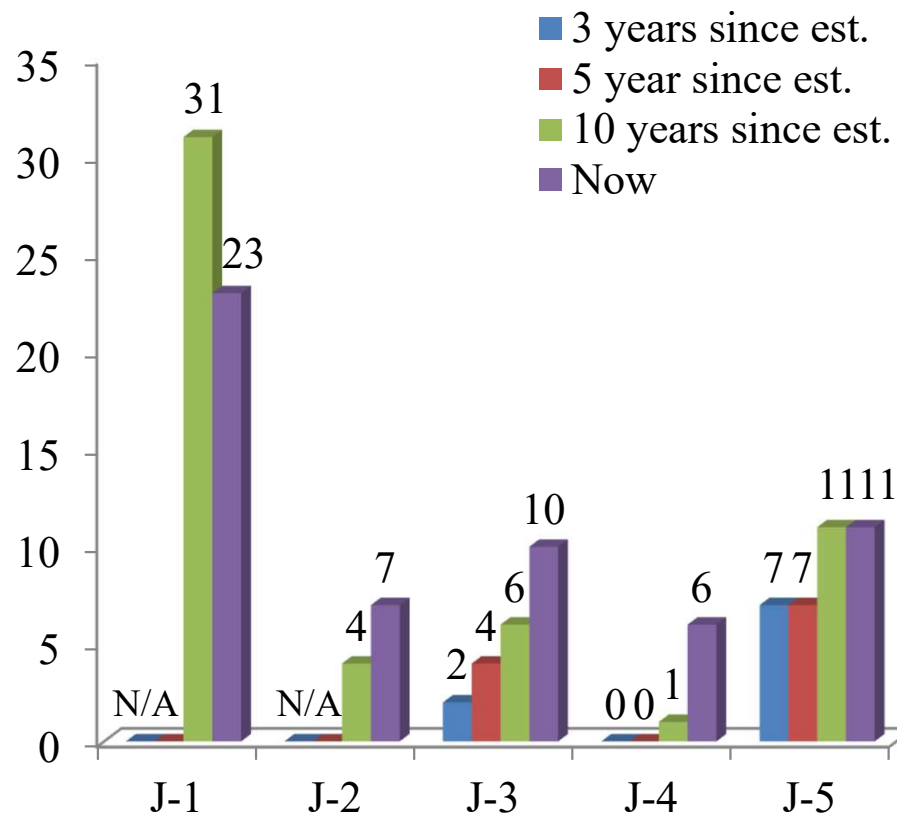
Human Capital Formation

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”?!**

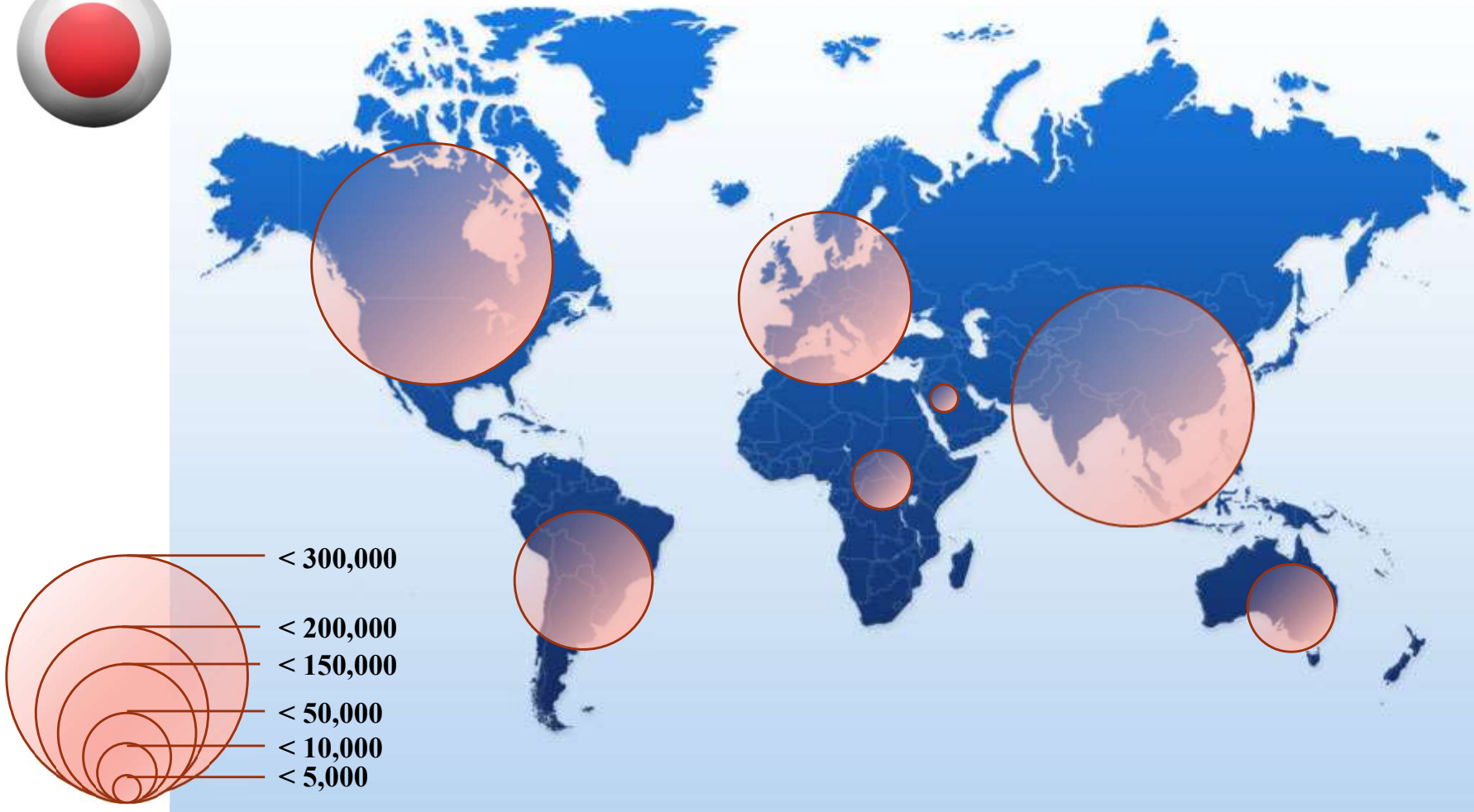


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Internationalization of Asian Firms



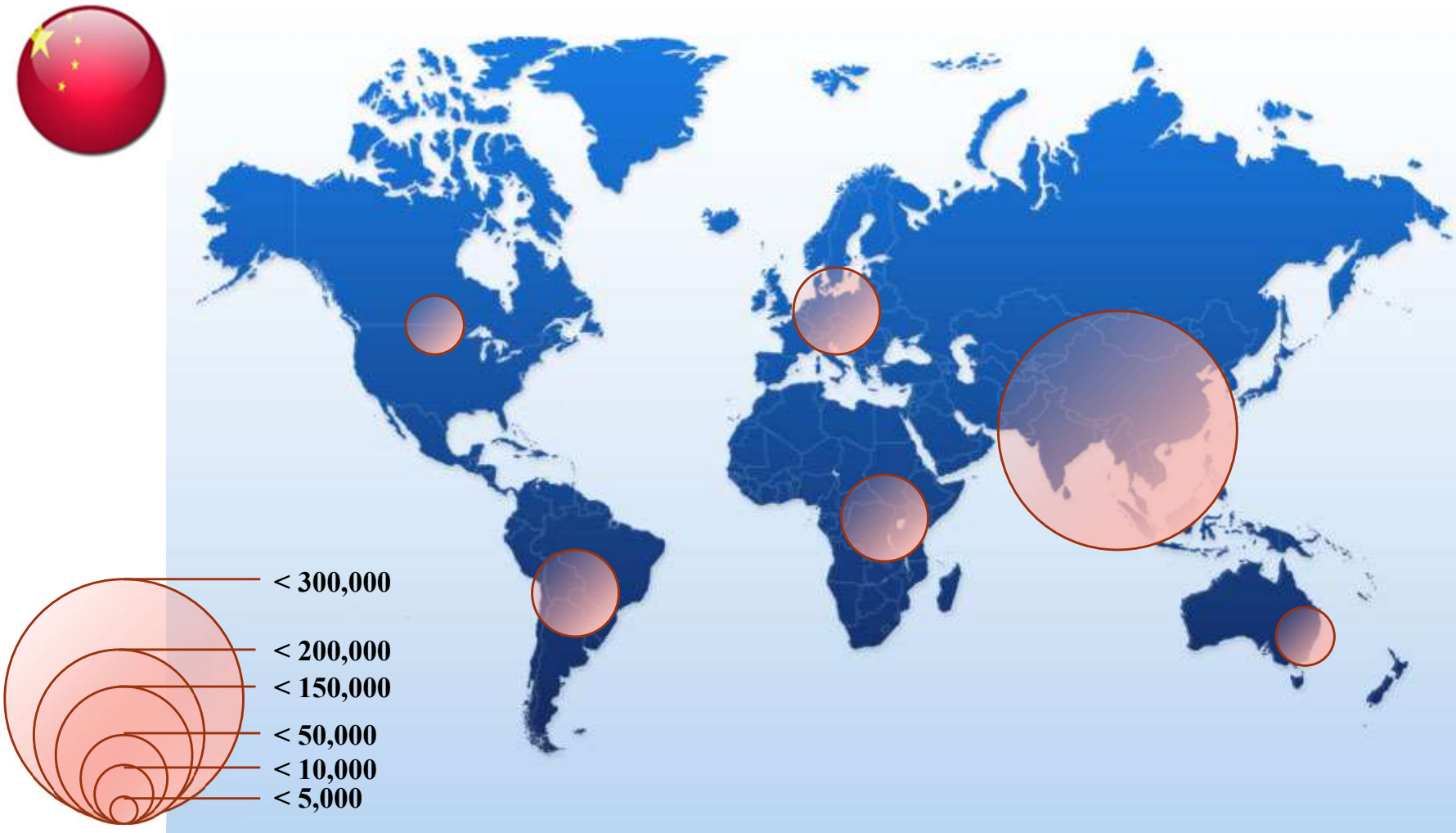
Japanese Outward FDI in the World (Unit: US\$ Millions)



Internationalization of Asian Firms



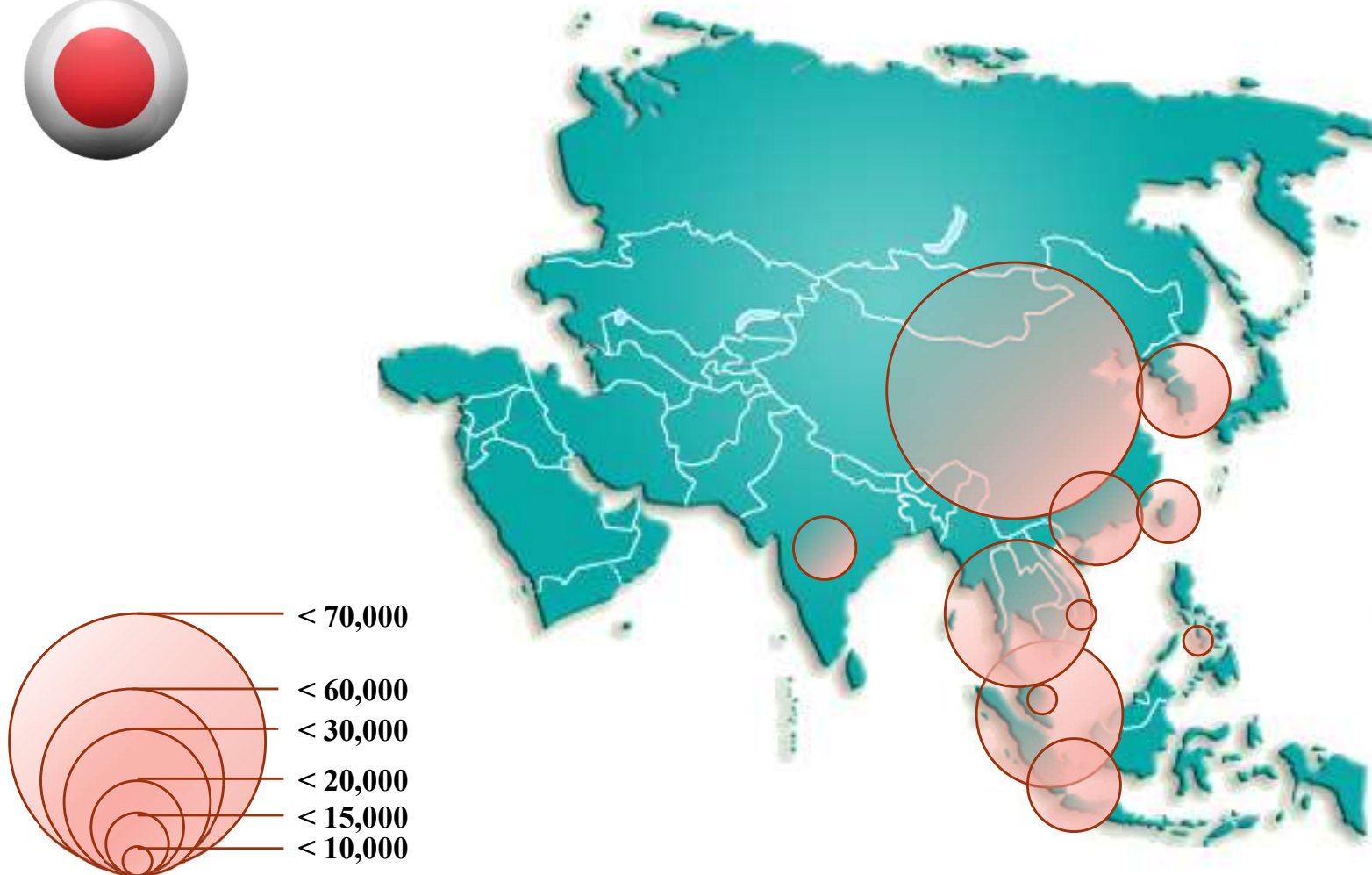
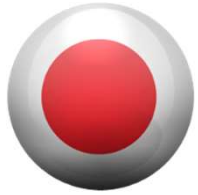
■ Chinese Outward FDI in the World (Unit: US\$ millions)



Internationalization of Asian Firms



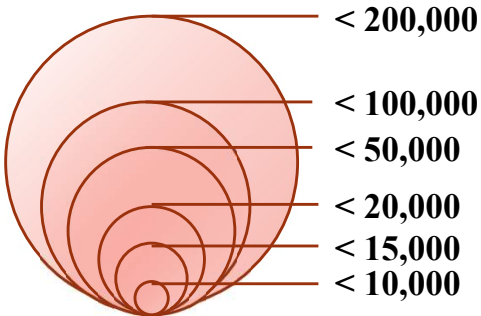
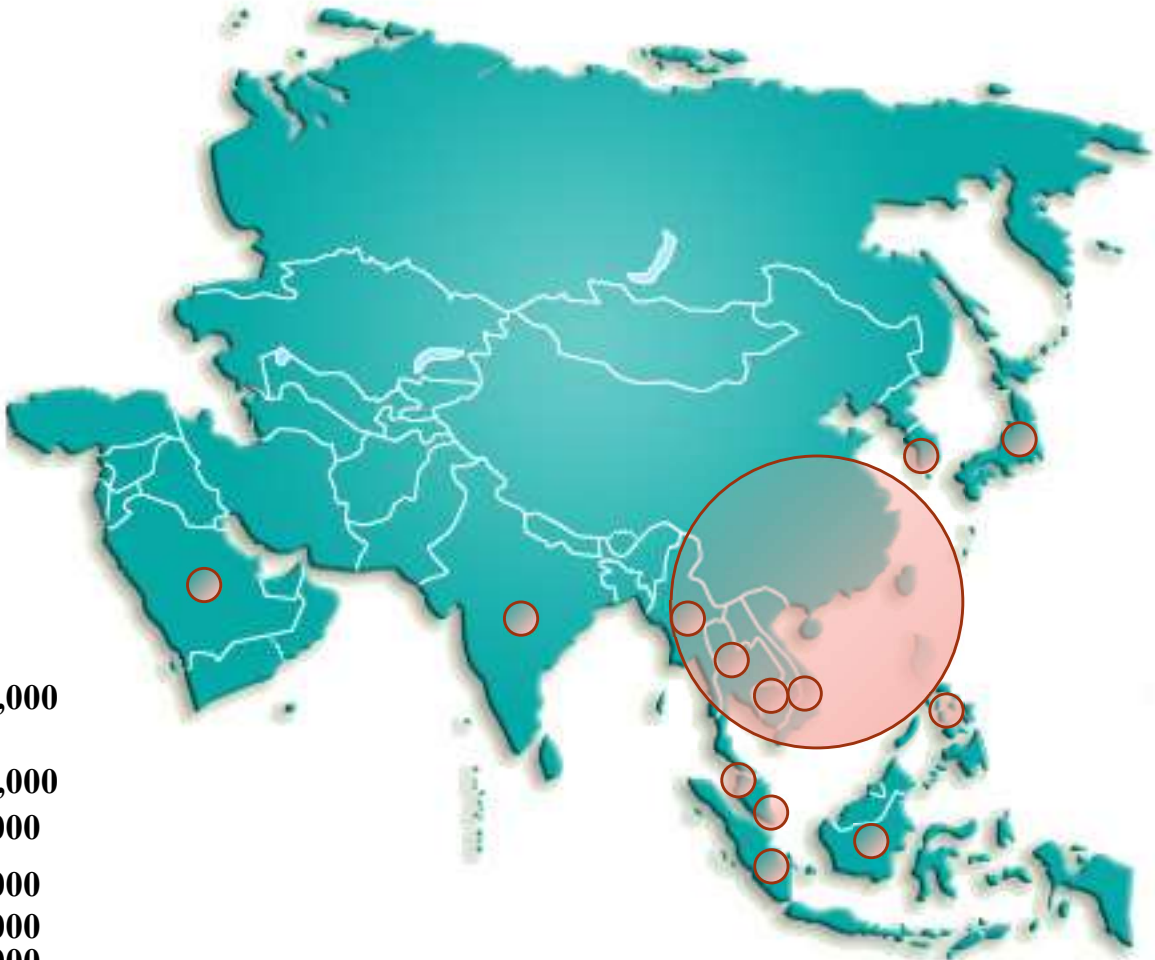
Japanese Outward FDI in Asia (Unit: US\$ Millions)



Internationalization of Asian Firms



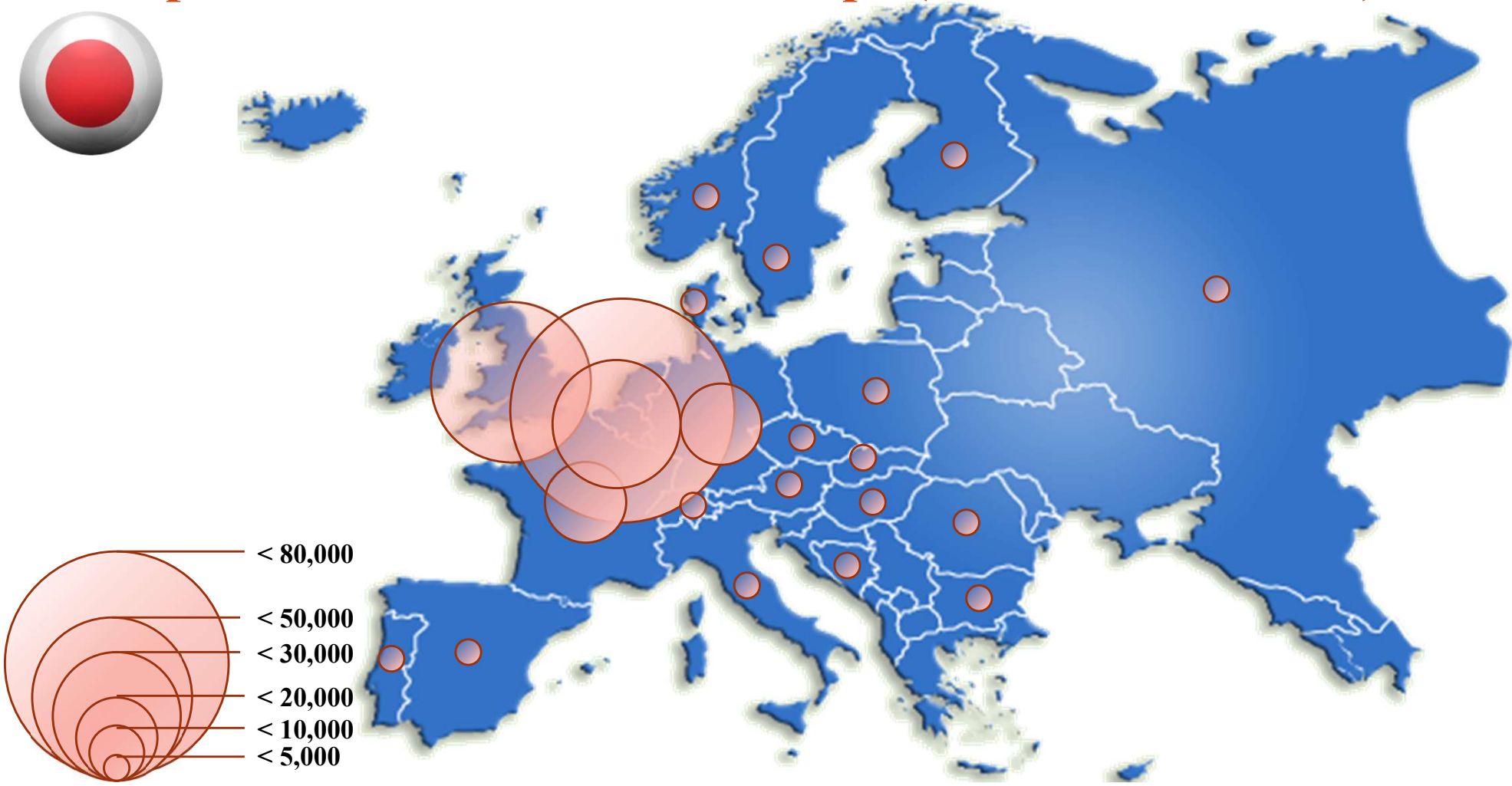
Chinese Outward FDI in Asia (Unit: US\$ Millions)



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).

Internationalization of Asian Firms



■ Japanese MNCs in China



COMMENTS

> Timing:

- The early 1990s
- The WTO membership

> Why do Japanese MNEs invest in China?

- Global value chains
- Market size
- Cheap labor force

> Location:

- 1. Shanghai (702), 2. Jiangsu (662), 3. Guangdong (523)

> Industrial focus:

- Manufacturing: 80%
- Service: 20%

Source: Own illustration based on Toyo Keizai (2007).

Internationalization of Asian Firms



■ JMNCs' Marketing Strategies in China (Buckley & Horn, 2009)



- Tailored its marketing to Chinese consumer behaviour.
- **Dominanto Senryaku**: Dominating particular areas.
- Individual consumer preferences are carefully monitored.
- Regional differences in style, colour & brand preferences.



- A hybrid of **localized & globalised facets**.
- Inclusion of **middle income earners** in the customer portfolio.
- Introduction of the **Aupres brand** only for the Chinese market.
- **High-quality/medium price range** positioning.
- Development of **ties with the local government**.



- Higher price segments (*e.g.*, **Lexus**).
- **Simultaneous launching** of product models.
- **Localised marketing** strategies (*i.e.*, speedy & flexible reaction to changes in market environment).
- **Word-of-mouth** communication.



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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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