



***Producer Environment's Impact on the Reverse Investment Strategies of  
Large Developing Country Firms***

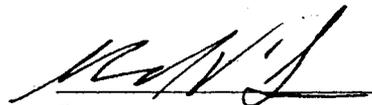
A thesis presented  
By  
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To  
The Department of International Business and the  
School of Business  
In partial fulfillment of the requirements  
For the degree of  
Doctor of Business Administration  
In the subject of International Business

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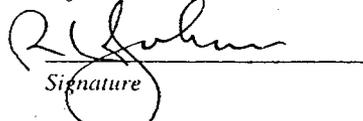
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## 1. Chapter One – Reverse Investment

### 1.1 Introduction

Throughout the 1980s and into the 1990s financial investors, corporate strategists and political leaders from the world largest economies were engaged in intensifying their focus on emerging or developing economies. The developing economies were seen as the new frontier for economic growth for some of the world's largest corporations. Not only did these developing economies provide the picture of opportunity – companies in the industrialized world became dependent upon on overseas markets for both economies of scale and increasing profits. Simultaneously, developing economies benefited as well. Capital, technology and management expertise flowed into these economies providing a basis for economic growth.

However along with opportunity comes risk. Financial shocks rocked the global economy in the mid 1990s, (beginning with the peso crisis that struck Mexico and then followed by the Asian financial crisis). Political instability in the form of increased crime, kidnapping, assassinations and guerrilla activity were on the rise. These economic and political shocks became the impetus for "*capital flight*", sending capital fleeing back to the safe haven of their domestic markets or other stable advanced economies.

Firms in developing economies were forced to consider alternative avenues for increasing their economic well-being. One alternative that can be given serious consideration is *reverse investment*. Historically, developing nations have participated in foreign direct investments (FDI) outflows to more

developed and advanced economies. Albeit, the level of flows have been miniscule in comparison to the outflows from advanced nations, over time these outflows are becoming a significant factor in the development of transnational firms from developing economies. This activity is the focus of this thesis.

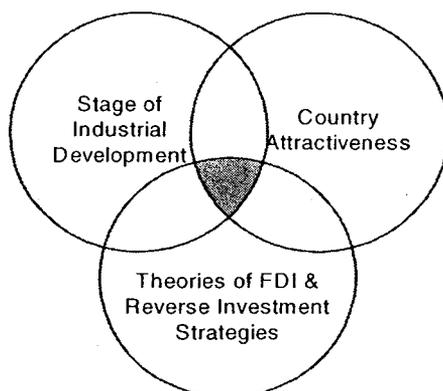
## 1.2 Objectives of the Research

This study is designed mainly, to develop deductively a set of rules as to *who* (what type of firms from which industries) participate in reverse investment, *why* do they participate and *where* are these reverse investments directed.

Historically, most of the FDI invested into developing economies came from the Triad – the US, the European Union and Japan. In 1998 the first major decline in FDI inflows to developing nations by advanced nations was noted, WIR (1999). In contrast, technology flows to developing countries during this time period continued to grow. Technology has been one of the key factors associated with economic and industrial growth in developing countries. The level of technology growth has varied throughout the developing economies. This is due in part to the country's ability to attract technological resources. This would imply that nations at higher levels of industrial development would be in a better position to attract technological resources over other nations. FDI is often a catalyst for spurring these technology transfers, and industrialized firms are the vehicles used most often to engage in FDI.

The objective of this thesis is therefore to combine the topics (*figure 1.1*) of the stage of industrial development, country attractiveness and theories of FDI

and international production to analyze the interplay of these topics on the impact of reverse investment strategies for firms in developing nations.



**Figure 1.1**

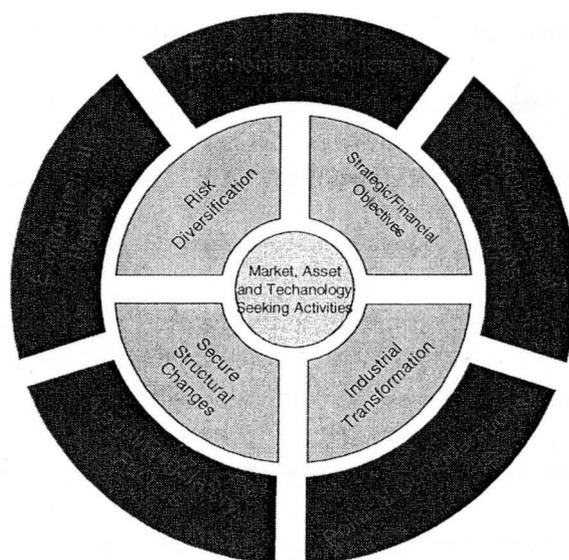
An industry leading firm's stage of industrial development often signifies the direction that the industry is taking and this serves as a benchmark for other firm's in the sector. The firm's industrial development is directly tied to its core competencies. Industry attributes or characteristics are generally an accumulation of the core competencies of the industry's leading competitive firms.

Countries seeking to attract certain industries (or firms) within their borders take note of these key attributes and try to build or accommodate these factors in their producer environments. There are times when these factors are naturally present in the producer environment, such as in the case of environmental or social/cultural factors and at other times governments intervene to interject these factors into the environment, particularly when they are in the realm of legal or regulatory policies or practices, and to some extent when they fall under political or economic conditions.

How a developing country firm reacts to the intermingling of these conditions, particularly when factors in its home producer environment force a decision to seek new geographical locations, will have a direct bearing on their reverse investment strategies. It is the analysis of the interplay of these conditions that will form the basis of this dissertation.

The approach of this study is both normative and positive. A normative theory examines characteristics, relationships and the actions that should exist. The important point is that normative theories are not necessarily empirically based. Such theories rely on deductively plausible analysis of human behavior or expected consequences of actions. The positive approach describes what actually happens. Its findings are derived from actual observation or data or real world behavior. It is inductively based, subjected to rigorous tests to verify or refute some proposition or belief. This is done when the issue being investigated is developed into a testable hypothesis. The larger part of this text focuses upon what logic suggests might happen and it uses deductive reasoning. Before posing any hypothesis in regards to the research question, it is critical to establish the realm in which the investigation of the problem will take place. There are numerous factors that affect a firm's decision to make an international investment. Some are generated by the firm's internal environment, while others are present in the external environment in which the firm operates. These internal and external factors are discussed below.

When considering international investments in this study, three fundamental questions must be addressed: *Why* make the investment? If the decision to make the investment is approved, *how* will it be accomplished (by what methods)? And finally, *where* will the investment take place (the geographic location)? Figure 1.2 depicts a representation of the fundamental requirements of an international investment.



**Figure 1.2**

The question of why invest is best described by the middle circle in the diagram, which suggests that there are numerous business reasons for considering overseas investments, such as; risk diversification, strategic and financial objectives, securing structural changes in the organization, and industrial transformation. The methods or more accurately the strategic motivation for accomplishing the investment objective are best described by the smaller, inner circle which details the methods in which firms can exploit their firm specific advantages, which come in the form of market seeking, asset seeking and

technology seeking activities. The impact of these activities as noted in reverse investment research will be discussed further along in the dissertation. Which brings us to the final outer circle that examines those factors in the external physical (or producer) environment, which impact the location in which the investment will take place. While a firm can contribute to the development of several of these factors, for the most part, they are out of the firm's direct control. Research in the area of industrial production and geographical concentration; explain that firms locate in areas where they benefit from endowment factors resident in the physical location. This attraction in some way must be in line with the firm's capabilities that are usually tied to its level of industrial development. Porter (1990), in looking at industrial clustering, noted that firms with a high level of industrial development are often the anchor firms in an industrial cluster, and other firms are drawn to join the cluster when they can also benefit from the "technological spillovers" as well as the country attractiveness.

Country factors that in one case may "pull" a firm into its borders may in fact be the same ones to "push" the firm from its home producer market, or other conditions in the home producer environment may end up being the driving factors.

Previous research into reverse investment strategies has tried to determine if the FDI has been strategic asset seeking or asset exploiting and whether or not these factors will drive the investment in a particular direction. A more detailed discussion of this research will be set forth in chapter 2.

To avoid any confusion later in the text, some clarification of terminology may be appropriate. The acronym *DCMNC* (developing country multinational corporation) will be used to describe a firm whose parent country is from a developing economy. These companies will have at least one subsidiary located outside of their home country. *MNC* (multinational corporation) will be used as the designation for firms from developed economies. By way of definition, *MNC*'s are considered firms having operations in more than one country, international sales, and a nationality mix of managers and owners<sup>1</sup>. Reference will also be made to "*upstream*" and "*downstream*" countries. For the purpose of this study, upstream and downstream countries in the sample list in appendix A have been categorized as follows: North Africa and the Middle East; Sub-Saharan Africa; Europe; Asia; North America (excluding Mexico); Latin America and the Caribbean; and Oceania. Upstream countries are considered those located in North America and Europe, while downstream countries include everyone else. It should be noted that no distinction is made in this classification to separate newly industrialized nations from less developed nations. This is due in part to the fact that the designation newly industrialized nation was associated with a core group of developing countries in Asia (Hong Kong, Korea, Singapore and Taiwan), and by some accounts, these nations no longer can be considered "*newly*" industrialized, and further because the designation has not been consistently applied to countries in other geographic locations.

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<sup>1</sup> Defined by Hodgetts and Luthans (2000). It is an upgraded definition of that used by the Harvard Business School, Horst (1972), which defined firms from developed countries, engaged primarily in manufacturing, with several subsidiaries overseas. Vernon (1971) further elaborated on the HBS definition by defining several as having six or more subsidiaries.

Specifically, three objectives of the research will be pursued:

1. Does the case analysis fall in line with previous results from other research into reverse investment strategies for developing country firms?
2. Does the push-pull effect of producer environments affect the direction of international investment?
3. Does the direction of the investment impact firm profitability?

Original, deductive analysis is the means of pursuit of the former two objectives and empirical investigation underlies the third. It is intended that the research will make the following significant contributions to the field of learning in both international business and foreign direct investment by:

- (a) Further explaining the interrelations of internal firm activities to the external producer environment in which they operate.
- (b) Add to the growing body of knowledge and information on reverse investment activities for developing country firms.

It is intended that the results of this research will be beneficial to a cross section of communities, including academic, governmental and private sector.

### **1.3 Reverse Investment Defined**

The concept of reverse investment can be viewed in two ways. The first perspective is to look at investments from developing economies being made into advanced or industrialized economies, upstream investments. Outflows of foreign direct investment from the developing nations, to industrialized nations of the

United States, the European Union and Japan have been relatively small, especially from the less developed economies, and have been made by relatively smaller transnational corporations than those found in advanced economies. Empirical studies, however, have shown that small to medium sized multinational firms played a significant role in outward investment, Buckley, Newbould and Thurwell, 1988; Kohn, (1977). Conventional theory explains this concept by attempting to identify firm-specific advantages unique to these seemingly smaller firms. Wells (1993) identified possible advantages such as superiority in small-scale production and flexibility in switching product lines. A contrasting viewpoint forwarded by Gomes-Casseres (1997) and Kohn (1997) was the identification of a group of international investors, who were small in size, but strong in technological capability, as well as dominant in certain niche markets. In the markets in which they competed and excelled, these firms were relatively large compared to their peers. Therefore the industry in which they competed had a lot to do with their success. It was noted that in order for these firms to maintain their leadership in these niche markets, they would venture overseas to exploit new markets, develop new products and deepen their expertise.

The second definition of reverse investment is when firms from developing countries enter other developing economies. The more developed developing nations, particularly in the Asian region have been generally characterized as the newly industrialized economies (NIEs)<sup>2</sup> or emerging

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<sup>2</sup> The term newly industrialized economies (NIEs), or the “four tigers” as often referred to in the literature may be a somewhat outdated term of reference for the economies of Hong Kong, South Korea, Singapore and Taiwan, as these nations have an established history of industrialization. A “second tier” of countries from East Asia, referred to as the ASEAN-4, (Indonesia, Malaysia, the

economies. For example, in Asia, the more commonly known NIE's (Hong Kong, the Republic of Korea, Singapore, and Taiwan Province of China) or “*four tigers*” as they are often referenced, are prominently known for their industrialized firms. The use of the term newly industrialized hardly seems appropriate, particularly in reference to these Asian economies, as they have grown to a significant level of development and there is a second tier of economies is rapidly making their mark in East Asia, in the countries of Malaysia, Thailand, Indonesia and the Philippines. A possible third tier, Indochina is gaining more attention, with Vietnam being the lead country in this group.

Some Latin American countries, such as Mexico, Brazil, and Chile are also developing into industrialized nations, however their pattern of industrial development has not seemingly been as systematic as their Asian counterparts. To a great extent, Asian nations greatly benefited from trade agreements specifying investments in other developing Asian countries.

As there is limited agreement on using the various classifications in a uniform manner across cultural boundaries, the study will stick with the generic classification of all developing economies into the category of downstream countries.

#### **1.4 The Importance of FDI from DCMNCs**

The examination of foreign direct investment has been a captivating topic for researchers since the early 1960's. Much has been written on why firms from

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Philippines and Thailand) are developing industrialized characteristics similar to those noted in the original newly industrialized or emerging economies.

developed economies have sought this form of investment over other alternative means of foreign expansion. As a point of definition, foreign direct investment has more commonly been referred to as the process of developed country firms setting up foreign subsidiaries through investments in overseas production. This study finds as a related topic of query and interest, the extent to which multinationals from developing economies are engaged in this type of international investment strategy. In part this interest, or academic curiosity, stems from the fact that countries, which are often considered limited in capital accumulation, and often not thought to be leaders in the arena of industrial activity, would be exporters of capital, technology or both.

Developing countries' participation in international production was, until a short time ago, conducted mainly to host foreign affiliates of MNCs, which had been welcomed as a method of establishing and strengthening an industrial base for economic development. The past three decades have shown a turnaround in this thinking, as firms from developing economies have been investing abroad, at an ever increasing rate, giving rise to industrial production themselves, Kumar and McLoed (1981) and Wells (1983). Figure 1.3 below shows how developing countries compare to developed nations in terms of FDI outflows.

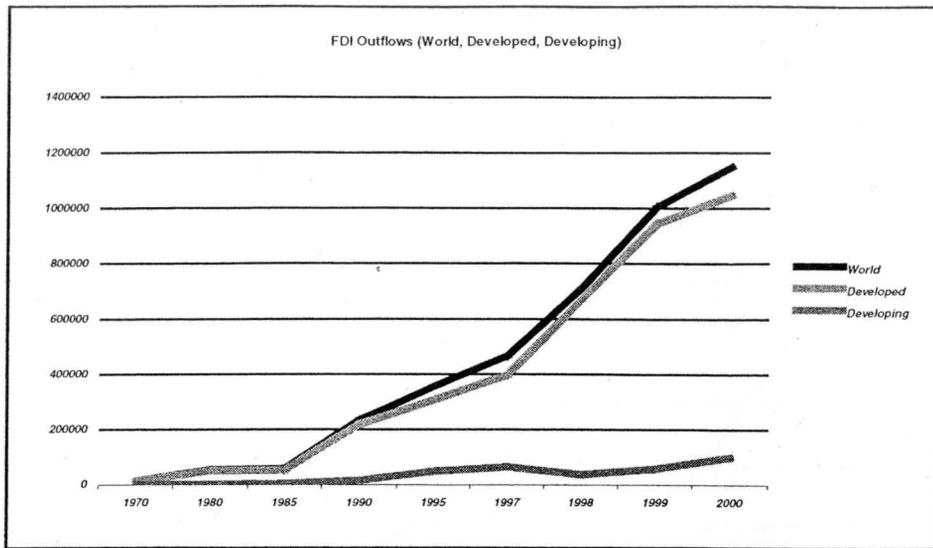


Figure 1.3

From 1970 through 1985 outflows from both developed and developing economies were quite similar. In 1985, developed economy FDI outflows began accelerating, and the gap has been widening at a phenomenal pace ever since. An interesting point of reference is in 1997, the year of the Asian financial crisis. Not surprisingly, outflows from the developing economies dropped during this time period. However, the same was not the case in the developed world. Outflows increased for developed countries. It can only be hypothesized that since there was an increase in outflows, there must have been a directional change. Many developed countries, began shifting their flows to more advanced economies to avoid the volatility of the nations in crisis.

In figure 1.4, a snapshot of developing countries' FDI outflow participation, over the same thirty-year period is provided. Ironically, the patterns for the different developing economies are quite similar until the year 1999, when FDI outflows from Asian countries escalated and other economies, particularly, in

the America's (*the America's are comprised of Central and South America, along with the Caribbean*) made a sharp decline.

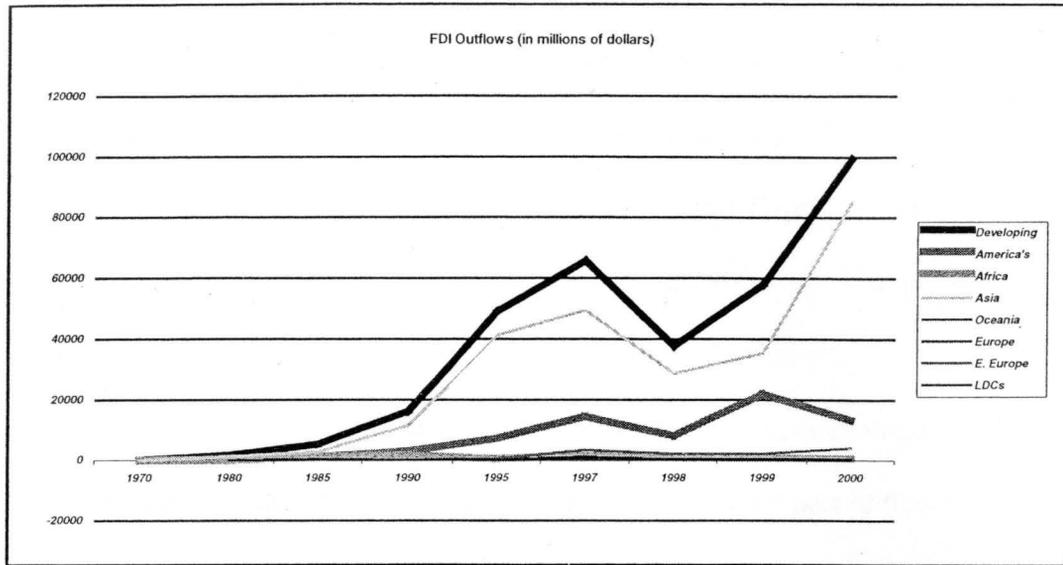


Figure 1.4

DCMNCs making foreign direct investments in developed nations are not a new phenomenon. Argentinian firms were actively involved in manufacturing, trading and financial activities in Latin American countries before World War I, Lall (1984). The late 1960s and early 1970's saw a rise in DCMNCs, with a more significant increase coming in the 1980's. By the 1990's DCMNCs had garnered much attention on a global basis. Significant progress can be noted in the fact that the United Nations Conference on Trade and Development began systematically tracking transnational corporations from developing economies on a consistent basis in the early nineties. Table 1.1 in Appendix A represents the list of top transnational corporations from developing economies, and the location of their foreign subsidiaries, UNCTAD (1993-1997). Subsidiary information was obtained from the International Directory of Public and Private Corporations

2001. Data on subsidiary activity was segmented into seven regional areas: North Africa and the Middle East; Sub-Saharan Africa; Europe; Asia; North America (excluding Mexico); and Latin America and the Caribbean (including Mexico)<sup>3</sup>. The regional breakdown of investments is noted at the end of the table. Of the 369 subsidiaries associated with the 96 firms identified in the table, the majority of the subsidiaries are located in Asia (34%). This is not surprising given that Asian firms represent over 60 percent of the firms in the survey. Europe and Latin America have the next highest representation respectively.

Intra-regional investment is a key part of the investment strategies for these corporations, and there is substantial investment on the part of these firms in the regions in which their parent companies are located. Africa for example has 36% of its investments within the African continent (outside of South Africa), which is the primary investing country in the region. Asia and Latin America & the Caribbean both have over 43% of investments within their respective regions. As noted from the chart, several of these firms have extensive expansion in both developing and developed economies. In particular, firms such as Daewoo (Korea), Acer (Taiwan), LG Electronics (Singapore) and YPF (Argentina) have over 20 foreign subsidiaries. Of the 96 corporations represented during this time period, over one-third have foreign direct investments in the developed economies – primarily the Triad – represented by North America (primarily the USA), Europe and Japan.

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<sup>3</sup> While it is intended that regional groupings be consistently maintained throughout this study, variations in the source of data may cause slight variances in terms of what countries are included in a particular regional group. Every attempt will be made to keep the groupings consistent.

What causes this to be an interesting topic of study is the focus on two key factors:

- (a) Understanding the motivation for firms from these economies to engage in cross border investments in countries that are economically more developed.
- (b) And the analysis of the interplay of the producer environment on the investment decisions.

From the mid-1980s to date a change in the geography of FDI has been noted. A number of factors (or forces) that either independently or in consortium with each other, have been attributed to impacting the rate and direction of capital flows. Some of the major factors include: (1) global interdependence; (2) protectionism and growing economic blocs; (3) transnationalization<sup>4</sup> of multinational corporations (MNCs); (4) rapid technological advances; (5) conflicting politics and tribalism; and (6) growth of environmental concerns.

As reverse investment may be considered as a counter-intuitive form of FDI, it can be examined same conditions that have applied to FDI for MNCs, which goes back to our diagram on page 8.

Research into the area of reverse investment is significant for several reasons: (1) Developing countries are becoming a significant location for transnational corporate activity for firms in both developed and developing economies; (2) the topic is fertile ground for researchers, as systematic conceptual

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<sup>4</sup> The concept of transnationalization refers to those firms that have a strategic orientation in which they develop global efficiency, flexibility and worldwide learning capability simultaneously and the configuration of assets and capabilities are dispersed, interdependent and specialized.

and empirical investigations are still needed in this arena in order to build consensus in this research and; (3) this research will be useful to government's assessing factors that attract FDI to their nations, corporation's which are considering FDI investments and academian's whose research interest is in emerging economies and FDI.

### **1.5 The International Investment Decision Process**

The perspective traditionally taken in foreign direct investment decision-making is normally static. Static in the sense that investment decisions are assumed to be set in advance, based in part on the fact that finance theory assumes a project will be evaluated against its base case, what will happen if the project is not carried out. Unless the base case is realistic, the incremental cash flows will mislead. But in reality, the decision made by managers frequently attempts to be as flexible as possible on as many operating fronts as possible, enabling managers to alter direction in responses to positive changes in the business environment or in avoidance of potentially negative pitfalls. The forces leading an organization to consider the possibility of engaging in a project outside of their home country might be classified into those arising within the organization and those exogenous to it, conditions stemming from its environment. Ultimately, the decision must be made based upon the goals sought to be achieved by the organization. A frequently quoted goal in both economics and financial management is the maximization of profits, or more specifically the maximization of the present value of the interests of the equity shareholders in a firm. This shareholder

focused goal, while quite important, is but one type of goal oriented focus that companies create. Firms in developing countries often have greater ties to economic and social systems which dictate a greater level of focus on goals which may be more ideological in nature. Governments in developing countries have often been the substitute for the market or if not a substitute, at least a supporter of business. Oftentimes, governments determine the nature of the industries that are critical to the development of their countries economies. Political relationships between countries, due in part to trade agreements, are also key in setting the focus for the company. Mason (1958) summarized the impact of collaborating relationships by noting that the corporations conduct their affairs in such a manner as to maintain an equitable balance amongst various constituents. This view was also supported by Cyert and March (1963) when they argued “that the goals of a business are a series of more or less independent constraints imposed on the organization through a process of bargaining among potential coalition members and elaborated over time in response to short run pressures”.

Central to the process of successful goal attainment is the process in which decisions within the organization are made. Aharoni (1966) subscribed to a more rational model of decision making that dealt with a number of key factors in the process such as the organization and the environment in which the decision will take place, the dimension of time in which the decision is made, the level of uncertainty which exists, the goals to be achieved and finally and constraints that exist. This rational model of decision-making assumes that the decision makers tend to search for all possible courses of action, compare and evaluate them and

finally choose the optimal solution. However, not all decision-making is done in this traditional manner. A number of researchers writing on organizational decision-making, such as Simon 1957 and 1960, March and Simon (1956) and Cyert and March (1963) have determined that there is a divergence between the model and the real world when it comes to making actual decisions. This alternate decision-making approach, often termed the bounded decision-making model, is characterizes decisions, which are made with incomplete information, under time pressures, and/or possibly with decision-makers and/or constituents not in complete agreement on goals. A third decision-making process, the political model - see Butler, Hickson, Wilson and Axelsson (1977), considers shifting coalitions of interests and temporary alliances for dealing with a particular problem, where different constituents, who ordinarily would not do so, come together for the purpose of gaining mutual benefit.

In assessing the reverse investment process undertaken by developing countries, it will be important to acknowledge the decision-making model used by the country, in addition to examining the stage of industrial development of both the home and host country.

## **1.6 Methodology**

Data on the foreign investments of firms from developing countries have been difficult to acquire. Some governments in developing countries provide information on outflows, however the information is often incomplete. Non-government organizations have been collecting data on developing countries and

these secondary databases are accumulating the most accurate information available. These secondary databases from reputable sources will be a major contributor to the analysis of information in this thesis.

Additionally, case studies of firms in developing countries will be used to test the hypotheses and propositions associated with the thesis. Case studies can provide an invaluable assessment of the activities and motivations of firms in regards to their investment patterns and behaviors.

The combination of these techniques will provide the methodological process utilized to prove the hypotheses rendered.

## **1.7 Organization of the Study**

The organization of this thesis shall be as follows. The first chapter shall provide background and justification for reverse investment by firms from developing countries. The emphasis is on defining reverse investment and the impact of the reverse investment on the international investment decision process for firms from developing countries.

Chapter two will discuss the major theories affecting investment strategies abroad, with a major emphasis on foreign direct investment and international production theories. It also integrates the concept of country attractiveness with industrial development, identifying what are the key motivations or objective for investment activities by firms outside of their home borders. It is from these theories that the major framework for examining reverse investment will be built.

Chapter three explains the theory of reverse investment. It examines investment behaviors by firms in developing countries based on the impact of push and pull economies. Additionally, the characteristics of the firms in developing environments are examined to determine what characteristics are consistent with firms engaging in reverse investment activities.

Chapter four provides the analytical support for the thesis, through the use of case analysis, secondary data and other appropriate statistical techniques.

In the fifth and final chapter, a conclusion regarding the research study is provided. Implications for the theory are explained, as well as statements in regards to policy and practice. It concludes with a discussion of future research.

## **Chapter 2 – Theories influencing international investment**

### **2.1 The Internationalization Process**

In order to understand why a firm would chose FDI over other modes of entry into a country, it is important to first understand why firms participate in foreign activity. Why firms participate in international activity has been discussed across a number of theoretical bases.

The work of Adam Smith, “The Wealth of Nations” (1776), questioned the assumption that a country’s wealth depended upon its holding of treasure. He instead postulated that the real wealth of a country consists of the goods and services available to its citizens. This led us to understanding the importance of economic trade to a nation’s economic well being and development. Expanding on Smith’s early theory, which is often referred to as a theory of absolute advantage, Ricardo (1817) built a refinement to his ideas, putting forth concept of comparative advantage. This concept focuses on the fact that countries possess a comparative advantage in the production of those goods that it can produce more efficiently than other goods. While the country may have an absolute advantage in the production of two goods, its focus should be on resources aimed at exporting the goods in which its comparative advantage is not so great. These concepts formed the basic rationale for free trade, although they have been refined over time to suggest that countries tend to export those goods whose production requires relatively more of the factor inputs in which a country is relatively endowed. In Ricardo’s time, the concern was with the flow of goods among nations, with the assumption that factors such as capital and labor were immobile.

These assumptions are not relevant today. Today the focus is on why firms, rather than nations, trade and why they adopt policies such as exporting, licensing and investing directly in facilities overseas.

From classical trade theory we are able to succinctly describe the conditions under which a country generates goods and services in which it has an advantage, for local consumption, and subsequently for exports of the surplus to other nations. It can therefore be assumed to be reasonable to expect that countries will import goods and services where they have a disadvantage. Morgan and Katsikeas, (1997), noted that economic advantages and disadvantages may arise from country differences in factors such as resources endowments, labor, capital, technology or entrepreneurship. Classical trade theory leads us to the conclusion that international trade can be sourced to differences in production characteristics and resource endowments which are founded on domestic differences in natural and acquired economic advantages. What it falls short of offering is any explanation as to what causes differences in relative advantages.

The explanation can however be found in the *factor proportion theory*. One of the earliest models that can be examined is that of Heckscher and Ohlin (1933). Examining the factor production theory, countries will tend to generate and export goods and services that harness large amounts of abundant production factors that they possess, while importing goods and services that require large amounts of production factors that may be relatively scarce. Heckscher and Ohlin proposed that if labor were abundant in relation to land and capital, labor costs

would be low and land and capital costs high. If labor were scarce, labor cost would be high in relation to land and capital costs. These relative factor costs would lead countries to excel in the production and export of products that used their abundant, and therefore cheaper, production factors. The overall concept was that an increase in one brings about a decrease in the other. Both trade and investment are driven by different factor endowments between two nations. The motivation stems from the fact that factor price differentials would remain, leaving unrealized opportunities for firms to profit with their participation in foreign markets. The factor proportion theory extends the concept of economic advantage by considering the endowment and cost factors of production. It however has shortcomings when explaining the current rapid increase in foreign direct investment and international trade, which has continued without significant changes in factor endowments between nations. One of the outstanding issues that this theory does not address is the level of trade and FDI flows between nations with similar factor endowments, and a great deal of trade takes place in the manner.

Another theory, developed by Raymond Vernon (1966), attempts to explain world trade in manufactured products on the basis of stages in a product's life. The *product life cycle theory* suggests that a product is produced by the parent company, then by its foreign subsidiaries and finally anywhere in the world where the costs are at the lowest level possible. The essence of the international product life cycle is that technological innovation and market expansion are critical factors in explaining patterns of international trade. It is determined that

technology is a key factor in creating and developing new products, while market size and structure are influential in determining the extent and type of international trade.

Thus far, the theories of trade that were examined, explaining why trade takes place, have basically emphasized the differences among countries. This is typical of the type of trade that would occur between industrialized countries and developing, possibly more in line with less developed countries (LDC's) than with newly industrialized countries (NIC's).

It should be noted that observations of actual trade patterns reveal that most of the world's trade occurs among countries that have similar characteristics, specifically among industrial, or developed countries, which have highly educated populations and are located in temperate areas of the globe, Daniels and Radebaugh (1998). The country-similarities theory tells us that once a producer had developed a new product in response to observed market conditions in the home market, it will turn to markets that are perceived to be the most similar to those at home. Although the markets within the industrial countries might overall have similar demands, countries also specialize in order to gain acquired advantages. Countries do this through the apportionment of their research efforts.

The impact of having examined the trade theories is that an understanding of trade relations between trade partners can begin to provide a glimpse at key characteristics that attract firms to foreign countries. Several factors dictate the relationship between trading partners and these include: distance, competitive

capabilities, cultural similarity, relations between countries and to some extent the business cycles.

Nothing can fully explain product flows, but distance between two nations does account for a good deal of the relationships that exist. This is especially true where transport costs for products are high. Competitive conditions for products such as geography or natural resources are also important. For example, New Zealand has a favorable climate and soil conditions for growing apples. It has the ability to compete out of season with the Northern Hemisphere. However, other countries may also have these competitive capabilities. Therefore, New Zealand will need to find unique ways of making their competitive capabilities work for them. The possibility of increasing yields, selling directly instead of through intermediaries or other possible actions can provide them with unique advantages. Cultural similarity is best expressed through language and religion and this can help to explain the direction of trade. Given the level of historical colonial relationships that have been created, there is a great possibility of trade being conducted where business ties have been previously established. Political relationships and economic agreements among countries may discourage or encourage trade between pairs of countries, therefore, favoring some companies over others. There are numerous examples of countries struggling with political animosities, such as Cuba and the US, which provide examples of political relationships that discourage trade.

Before examining previous research directly related to reverse investment, it is important to examine the methods by which firms have propelled themselves into international investments.

## **2.2 The Motivation for Overseas Investment**

The diagram in chapter one provides the basis for many of the international investment decisions. The motivations, or methods used to take advantage of firm specific advantage, which can be considered activities normally directed at increasing the profitability of the firm are a key component that has been identified in research related to MNC investments, reverse investments and they are factors in this study.

The common methods, or activities, of maximizing and/or exploiting these firm specific advantages (market seeking, asset seeking and technology seeking) have been discussed extensively in research related to MNCs and they are becoming a focal point of discussion and analysis in research related to reverse investment as well.

Firm objectives can be generalized into two major categories: those activities which are designed to assist in increasing or maximizing shareholder wealth (profit activities) and those activities in which the firm engages itself to reduce risk (see figure 2.1).

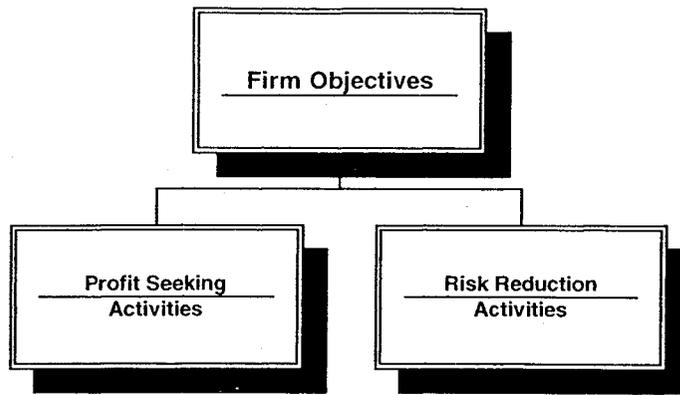


Figure 2.1

Depending upon the specific strategic intent of the firm, their profit seeking activities will fall into one of three categories; market, resource (asset) or technology seeking objectives as shown in *figure 2.2*. Risk reduction has generally been thought of, as reducing risk factors affecting only a particular firm, which quite often are consider diversifiable, since the firm can take specific actions to alleviate the risk.

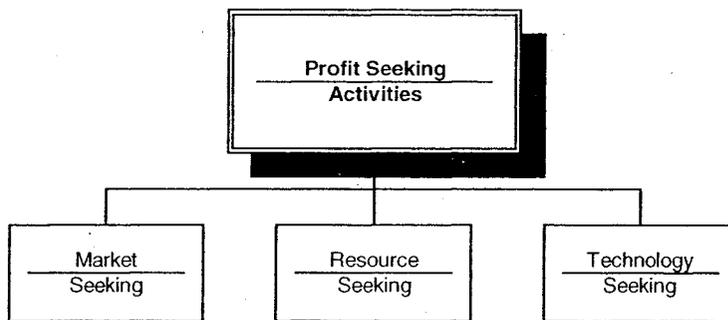


Figure 2.2

### 2.3 Profit Seeking and Risk Reduction Activities

These profit seeking and risk reduction activities will first be discussed in light of the literature surrounding MNCs. It will be followed by what researchers have *Resource seeking activities* – companies may engage in international

operations to acquire goods or services from abroad. These can be obtained by directly buying them from another company, however there are certain factors, which can favor FDI in order to gain certain resources. Firms desire to have as much control as possible over the production of their products. This process of *vertical integration*, which is control over the value chain, is often critical as products and their marketing become more sophisticated. In international vertical integration, raw materials, production and marketing are often located in different countries, requiring companies to consolidate these resources that are in various locales. Companies try to accrue the advantages of vertical integration through either market-oriented or supply-oriented investments in other countries. Supply-oriented investment examples have focused on the acquisition of raw materials in other countries. This has been key because a number of firms from developing countries have become dependent on emerging economies for raw material supplies. It had been thought that companies from developed economies would be more apt to have the resources necessary to invest in developing economies than the other way around. As will be noted in this study, firms from developing economies are adopting a similar strategy of investment.

At the firm level, firms seek access to resources or low-cost factors of production in order to become more competitive. There is a real need for global market penetration in order that the firm can exploit (1) economies of scale; (2) amortize large scale R&D costs and (3) take advantage of shortening product life cycles.

The manufacture of some products necessitates a high fixed capital cost for plant and equipment. For these products, especially if they are standardized or undifferentiated from competitor products, the cost per unit will drop significantly as output increases providing the company with scale economies. These companies can export in large amounts because the cost savings from scale economies often offset the high cost of transportation. Companies that need to alter their products substantially for different foreign markets will benefit less from scale economies.

R&D costs can represent a large portion of a firm's expenses. Firms need to have a large market in which to sell their products in order that their R&D costs can be spread on a larger scale.

The basic theory of the product life cycle is to show how for market and cost reasons, production often moves from one country to another as the product moves through its individual life cycle. At least three stages exist in the product life cycle, introductory, growth and maturity. In most cases, the introduction of the product occurs in only one (normally developed or industrial) country. As the product moves through the growth stage, production is often shifted to other developed or industrialized countries, with the original producer making a decision to invest in production facilities in these foreign markets in order to make profits there. As the product matures, the production then begins to shift to developing economies, which allows firms to continue to gain from scope and scale economies. Accurate and reliable competitive intelligence, as a result of

technology, is enabling competitors to shorten the various stages of the product life cycle, making it imperative that firms find new markets for their products.

From a financial perspective, firms that are able to reduce taxes and circumvent currency controls may find that these activities lead to greater project cash flows and a lower cost of funds. One of the key questions addressed about resource seeking firms is why these firms differ from others and how are they able to achieve and sustain competitive advantage. Penrose (1959) argued that the unique nature of firms give it its competitive advantage. Wernerfelt (1984) noted that if firms are evaluated based on the resources obtained, insights into their capabilities might provide a differing perspective from a more traditional industrial organization perspective. However, it was Barney (1986, 1991) who focused on the “tradability” that a firm’s strategic resources provided indicating that they could be translated into a level of monetary value. He further went on to explain that firm resources and capabilities could be differentiated on the basis of value, rareness, inimitability, and substitutability.

*Market seeking activities* - At the country level, location advantages or the comparative advantages of each nation’s set of resources provide different tone to the internationalization processes of firms, Dunning (1993). These advantages are often seen as political stability, domestic market potential, the availability and quality of manpower, a physical infrastructure, which can accommodate expansion activities, access to R&D resources and an attractive package of pro-business tax incentives.

Considering market-seeking activities at the firm level, issues such as transportation, trade restrictions country of origin effects and changes in comparative costs play a major role in these activities. When the cost of transportation is added to the production costs, there are some products that become impractical to ship over great distances. Large, bulky items such as steel are an example of this. If a company has excess capacity at its facilities, it may be in a position to compete efficiently in limited export markets despite high transportation costs. This could occur if domestic sales cover fixed operating expenses, which then positions the company to set foreign prices on the basis of variable, rather than full costs. This strategy could deteriorate if foreign sales become more important or if output nears full plant capacity. It has been noted that internationally, as well as domestically, growth is incremental. As operations reach capacity, more locations may be added. Often the expansion is into locations with close proximity to the original location. This is done partly to service the geographic region, save on transport costs, establish closer ties with customers and suppliers and to attain lower delivery costs. Some firms may even consider the acquisition of customers and/or suppliers in an effort to reduce inventories and gain economies in distribution. Growing companies may eventually find it necessary to include FDI into their strategic plan.

Trade restrictions imposed by the government are another issue to be dealt with. Governments can and do restrict imports. If this is the case, then companies find they must produce in a foreign country, if in fact they are able to sell there. These government trade restrictions tend to favor large companies that

can afford to commit large amounts of resources abroad, making foreign competition difficult for smaller companies who normally rely on exportation as a means of serving foreign markets. Import barriers must also be considered in conjunction with other factors such as market size of the country imposing the trade restrictions. Trade barriers can exist in many forms. While some are government imposed legal measures, others are limitations dictated by consumers. There are some consumers who prefer to purchase goods produced in their own countries, rather than in foreign-based countries. This partially due to their overwhelming sense of nationalism (a belief that these products are better than others) often supported by promotional campaigns organized by local firms to entice purchasers to buy local goods. Even though many nations produced similar looking goods, consumers many times view the quality of goods based on country-of-origin. Non-delivery for service and replacement parts is another reason for consumers to limit their purchase of foreign-based goods. This is particularly key if the producer is not well known or the demand for the product is not such that would warrant dealers to maintain a large inventory of parts.

A final issue in regards to resources seeking activities is that of changes in comparative costs. Firms export successfully when their home country has a cost advantage. Of course these cost advantages depend on the prices and productivity of the individual production factors, the size of the firm's operations, transport costs in relation to finished goods and any regulations in regards to production. These factors are not static, they are dynamic and this causes the least cost location to shift from one country to another.

*Technology/knowledge seeking activities* – A number of firms are considered innovation based multinationals. These firms create barriers to entry by continually introducing new products and differentiating existing ones, both in the domestic and international markets. They are typically characterized by spending large amounts on R&D along with a high ratio of technical to production personnel. Some firms enter foreign markets for the explicit purpose of gaining information and experience that can be used in another setting. One of the major drawbacks faced by innovation firms is the fact that as the industry matures, other factors must replace technology as a barrier to entry, if not, local competitors may succeed in replacing foreign multinationals in their domestic market.

*Risk reduction activities* – Companies can reduce risks by operating internationally, primarily through sales diversification. The use of FDI as a way of reducing risks follows along similar lines as discussed for market and resource seeking activities. There are, however, some specific reasons to use FDI to minimize risks such as following customers, preventing competitors' advantage and for reasons of political motives.

Many companies actually sell abroad indirectly. They produce and sell products, components or services, which ultimately may become integrated into a product or service that one of their domestic customers exports. Often as these domestic customers make the decision to expand overseas, firms, which are producers for these customers more than likely, may make the decision to follow them.

It is the goal of most companies to prevent or reduce the competitive advantage of their rivals. Particularly when it comes to oligopolistic industries, rivals will relocate themselves in the same countries, within a relatively short period of time of each other. In a number of industries, companies will experience capacity expansion cycles at similar times. Therefore, it seems logical that they will consider foreign investments concurrently as well.

Additionally, FDI also depends upon the political motives of some countries to reduce their security risk. China, through its national petroleum corporation, made substantial investment in a number of foreign countries to reduce its dependence on other foreign countries for oil supplies, Walker and Corzine (1997).

#### **2.4 Firm Objectives for DCMNCs**

Contrary to the market seeking motivations that MNCs participate in, DCMNCs marketing seeking activities follow a divergent path. Many investors from developing countries are very dissimilar to their industrialized country counterparts who have been so skilled at creating the image of differentiated products, in controlling distribution channels, in providing service, or in building a strong reputation with a few customers. Most foreign investors from developing countries rely primarily on one marketing tool, price. Therefore, they are more inclined to seek markets in line with their production capabilities and where success is not dependent upon other marketing tools not currently at their disposal.

From a resource seeking perspective, firms from developing economies are generally in search of financial resources. Often these resources are in short supply in their own countries. When political and economic conditions cause capital flight, these firms need to seek those markets in which capital is available. In addition to capital, there is a great need to find alternative sources of raw materials. Ironically, it was developing nations that were sought out for their raw materials, and consequently this is still the case. However, MNCs have often exploited the resources of nations and both MNCs and DCMNCs are both seeking nations, which can supply their material needs.

An overwhelming number of firms from developing nations are in need of technology to enhance their competitive position. For the most part, they are not comparable to the size of firms from advanced nation. Even the largest transnational corporations from developing economies do not hold assets at the level of MNCs. Their median foreign assets holdings are around \$1.5 billion – far below the median foreign asset level of the top 100 MNCs, WIR2000. While MNCs are focused on enhancing their oligopolistic position, DCMNCs are more concerned with adapting technology to the scale of manufacturing they perform, which entails more labor-intensive activities.

However, when it comes to risk reduction activities, the risk might actually increase for the DCMNCs. This is particularly true when they invest in more developed countries that are faced with the political and economic risks that may have driven MNC investment back to their home base or to safer environment. They also do not experience the kinds of diversification benefits

that MNCs often seek, as they are not engaged in resources seeking activities that will expose them to lower factors of production.

While both MNCs and DCMNCs both engage in similar expansion activities, their motivations often guide them in different directions. In the chart below, MNCs and DCMNCs are compared with each other in regards to their expansion objectives.

**Table 2.1 Comparisons of MNC and DCMNC Expansion Motives**

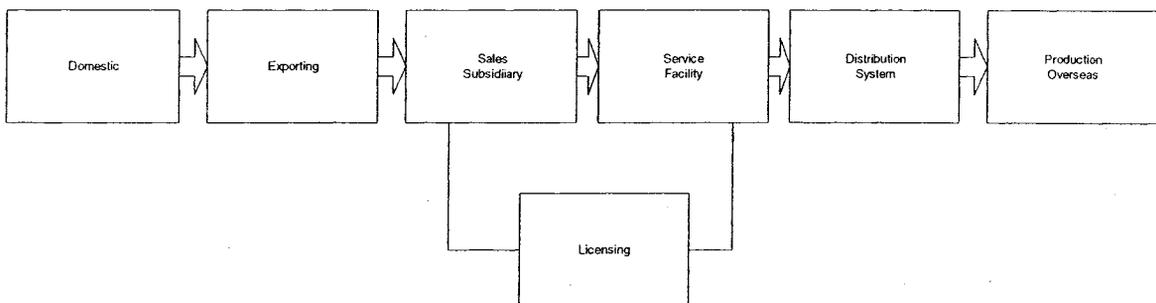
<b>Expansion Objectives</b>	<b>MNC Motivation</b>	<b>DCMNC Motivation</b>
<i>Market Seeking</i>	<ul style="list-style-type: none"> <li>- Market Size in excess of the domestic market</li> <li>- Economies of scale</li> <li>- Shorter domestic product cycles</li> <li>- Ability to circumvent currency controls</li> </ul>	<ul style="list-style-type: none"> <li>- Market size in line with production capabilities</li> </ul>
<i>Resource Seeking</i>	<ul style="list-style-type: none"> <li>- Access to low cost factors of production</li> <li>- Search for raw material sources</li> </ul>	<ul style="list-style-type: none"> <li>- Access to financial resources</li> <li>- Search for alternative sources for raw materials as sources in home countries are no longer secure, due to advanced nations exploitation</li> </ul>
<i>Technology Seeking</i>	<ul style="list-style-type: none"> <li>- Technology which can enhance the firm's oligopolistic position</li> </ul>	<ul style="list-style-type: none"> <li>- Adaptation of technology to small scale manufacturing that can fit more labor intensive activities</li> </ul>
<i>Risk Reduction</i>	<ul style="list-style-type: none"> <li>-Risk reduction through diversification actions such as following customers, limiting competitive advantage by entering the market simultaneously with the competitor</li> </ul>	<ul style="list-style-type: none"> <li>-Risk may actually be increased, particularly when going to more developed economies, where the same economic and political risks that MNCs were trying to avoid will still be present for the DCMNC</li> </ul>

Having explored the motivations for overseas investment, it is now time to turn the attention to the processes that firms employ in order to expand their operations.

## 2.5 A Sequential Process of Foreign Expansion

Johanson and Vahlne (1977) and Luostarinen (1977), described internationalization as a dynamic, evolutionary process. It basically moved through exporting to the setting up of a foreign sales subsidiary, then on to licensing agreements and contract, before finally becoming an actual investment in foreign production facilities. This evolutionary approach can be viewed as a risk minimizing process, much like Aharoni (1966) described. This gradual move from a low risk position, but easily reversible export-oriented policy, to a higher risk, but less reversible strategy of overseas production is often the route taken by many firms. It should be noted however, that there is rule stating that all firms follow this sequential process. Figure 2.3 provides an example of a typical foreign expansion sequence.

**Figure 2.2 Typical Foreign Expansion Sequence**



One of the most common vehicles for international expansion for MNC's is through exporting. Exporting allows both large and small companies to gain experience in the international arena. Often this initial experience can come through the process of *passive exporting*, filling overseas orders like domestic orders, or through *indirect exporting*, where an intermediary intervenes on behalf

of the company, Cullen (2001). Some specialize in certain products or they may have country or regional knowledge. Intermediaries provide the knowledge *direct exporting* and contacts necessary to perform overseas activities. Firms, which have more resources, may choose to take a more aggressive role by engaging in, which requires the firm to take over the responsibilities performed by the intermediaries, including but not limited to sourcing and using foreign sales representatives, foreign distributors or foreign retailers.

Exporting has significant advantages over other forms of foreign expansion. To begin with, when considering exporting, the capital requirements are minimal, there is relatively low risk, the profits can be realized immediately and the decision can be easily reversed. There is also a very steep learning curve effect with exporting, especially in the areas of supply and demand conditions, competition, distribution channels and other key aspects of business and cultural in a particular country, which contribute to a successful overseas experience. As knowledge is accumulated through export activities, firms may begin to expand their sales and marketing organization overseas. It may allow them to switch some of their operational activities, such as moving from export agents or other intermediaries to dealing directly with foreign agents and distributors. The switch to these activities often begins to give the firm a level of control over their operations.

As noted in the diagram above, a next move for companies may be to set up sales offices or subsidiaries. This move is undertaken when the demand for the companies' product is particularly high in a country or region. Companies need

to consider the expense of having a facility to house the sales operation, but more importantly, there is the expense associated with either transferring home managers to expatriate assignments or hiring and training local managers and employees to run the operation. Similarly, companies will invest in service centers when product demand is high and they want to have repair and warranty services close to the customer. Sales and service facilities overseas are beneficial to firms as they add more control to their overseas operations. They also allow firms the opportunity to have managers in the local environment, which provides more access to customer and competitive information.

If total control of assets is the ultimate goal of the firm, then consideration is given to locating production facilities overseas. FDI represents the ultimate level of internationalization. The domestic company owns in part or in whole, an operation in another country. This type of investment can be used to set up any type of subsidiary (R&D, manufacturing, sales, etc.) from scratch (*greenfield*) or it can be used to acquire existing companies, in another country. The motivation for overseas production for some multinational corporations has been to extract raw materials to support production at home. This kind of backward integration has been common in the steel, aluminum and petroleum industries, Cullen (2001). Other motivations include finding low-cost labor, components, parts or finished goods. Finished product or components can be shipped back to the home country or to other markets. However, the overriding motivation still remains market penetration. The scale of FDI often changes as firms gain greater returns from their investments or if they perceive less risk in running their foreign operations.

### **2.5.1 Profit Seeking and Risk Reduction Activities and their Affect on Revere Investment**

Early research on the investment activities of firms from developing countries originated about two decades ago, led by Wells (1977, 1983); Kumar and McLoed (1981); and Lall (1983) which focused on the issue of why foreign direct investment occurs from developing countries. Additionally, the focus of the research was uni-directional, with the concentration being on investments from developing to developing (downstream) countries. This early research omitted any mentioned of bi-directional or (upstream) investment.

However with the advent of the 1990s, research in upstream investment activity is beginning to appear in the literature. Researchers such as Lecraw (1993); Chen and Chen (1998); and Makino, Lau and Yeh (2002), have contributed to the literature by examining why and when LDC and NIE firms engage in upstream investment. A key determination in the Makino et al research was the finding that strategic asset seeking FDI would occur more likely in upstream countries than in downstream countries. They further hypothesized that resource-labor seeking FDI would occur more likely in downstream countries. This finding will be used to examine the case studies to see if parallel findings exist.

What is absent from the literature is a focus on the location of the investment. Examining the “where” of international investments for developing countries may provide the opportunity to consider one other factor related to foreign investment – risk reduction.

The concept of firms seeking attractive or receptive producer environments may be another way of addressing where firms go to reduce their risk. Much of the early literature on the multinational corporation (MNC) posits a diversification benefit for MNCs, leading to lower levels of risk and to subsequently higher levels of debt. However, even in the extensive research on developing country firms, this is still a controversial issue. Kwok and Reeb (2000) researched the issue of internationalization and firm risk, from an upstream/downstream perspective, by hypothesizing that the effect of internationalization on risk and leverage for MNCs would vary with home and target market conditions. The focal point of this research was that the relative business risk of a foreign market might also lead to changes in firm capital structure and risk. Kwok and Reeb posited that these effects are not dependent upon different currencies or legal systems but may simply stem from the different business risks of operations in those regions. Much like Modigliani and Miller (1958) suggested the existence of risk classes among firms, Kwok and Reeb (2000) suggested that there are risk classes among countries.

Kwok and Reeb tested their hypothesis in the empirical realm, using beta as the primary measure. Through case study analysis, I intend to show that restrictive producer environments impact the risk reduction activities of developing country firms, creating different classes of risk for firms based on their level of industrial development and their methods of engaging in profit seeking activities.

### **2.5.2 Summary**

Over the past two decades, firms from developing nations have increasingly invested abroad - \$66 billion in 1999, compared to \$1.7 billion in 1980, WIR2000. Firms from Asia have dominated these outflows, although firms from Latin America are consistently venturing abroad. Firms from developing economies may find certain advantages in seeking alternate avenues to international production expansion. While exporting has been a means of ease of entry into international markets, the benefits do not overcome the drawbacks to the mode of entry. Licensing is often not a preferred entry mode by developing economy firms, as for the most part they are smaller in nature than their advanced country counterparts and they normally do not have technology at the advanced stages of development. Often the host country government who has policy or legislation governing the activities of firms abroad may dictate an impetus for the mode of entry, which for many developing firms has been engaging in joint ventures. However, M&As are becoming a driving factor in FDI flows and this alternative is being executed by developing economy firms as well.

### **2.6 Foreign Direct Investment Theories**

The historical effect of FDI can be traced back to the late nineteenth century, during which the Victorian and Edwardian era saw the creation of many of the great vertically integrated multinationals that are recognized today, such as colonial plantation companies like Lever Brothers (now Unilever) investing in West African vegetable oil plantations, Cadbury's in cocoa, Dunlop in rubber,

Buckley (1998). Great Britain was seen as the great industrial power at the time, and was therefore a dominating force in international business. After the second world war, the baton was seemingly passed to the United States, with companies like General Motors, IBM, ITT and others developing manufacturing operations in numerous locations around the globe. By 1960, Japan was beginning to see a growth in multinational corporations; however, it was not until the late 1980 that the Japanese share of the world's accumulated FDI grew to over 12 percent OECD (1992). Limitations exist within international trade theories in providing a complete explanation as to why firms choose to invest in foreign business activity. In an attempt to move beyond the limitation of trade theory, another group of theorists attempted to fill the gap by addressing the question through foreign direct investment theories. This theoretical body of knowledge zeros in on several subsets of FDI such as market imperfections theory, international production theory and internationalization theory.

With the work of Hymer (1960, published 1976) and Dunning (1958), a new era of industrial organization theories regarding FDI and multinational corporations began to emerge. Hymer's contributions while basically theoretical in nature began to explore the issue of why a firm would consider participation in a foreign market. His focus was on market imperfections. The market imperfections theory states that firms constantly seek market opportunities and the decision to invest overseas is best explained as a strategy to capitalize on capabilities not shared by competitors in other foreign markets. These capabilities are determined by market imperfections for products and factors of production.

Hymer began by exposing the difficulties that firms have in entering unfamiliar markets such as differing languages, cultures and preferences, which place firms operating outside of their home markets at a cost disadvantage to local competitors. Hymer postulated that the only way to compete successfully in these foreign markets is to capitalize on some internal firm specific advantage that would neutralize the cost disadvantages that they would face.

Empirical support for Hymer's theory could be noted in work conducted by Dunning (1958). Dunning studied American firms operating in Britain, noting several activities, such as a higher level of productivity, a greater level of innovation and a higher wage scale as being firm specific advantages over their British competitors. What followed the work of Hymer and Dunning was a series of research focused on determining the exact nature of the firm specific advantages displayed by successful multinational corporations. Several hypotheses were developed such as intangible assets (Caves 1971,1982), multi-plant economies of scale (Scherer et. al, 1975), and the supplier relationships, which cause suppliers to follow customers abroad providing such intangible assets as advertising or financial services.

A different view comes from the *industrial production theory*, which suggests that the propensity of a firm to initiate foreign production will depend on specific attractions of its home country compared with resource availability and capabilities within other countries. In his groundbreaking work on assessing the competitive advantage of nations, Porter (1990) noted that the role of an "*attractive home base*" is to make available to firms seeking to invest within its

borders, a set of country specific assets which, while providing no direct advantage to the firm in the markets for its final products, aid the firm in its attempts to create and improve firm specific assets which can provide advantage. He also noted in his work, that if a firm emanated from a weak home base, it could in fact seek participation in a stronger asset base through a foreign direct investment. Porter (1985) notes that the reality of imperfect competition, which is reflected in industrial production theory, is that firms gain different types of competitive advantages, and these gains are realized to varying degrees.

Central to this theory is understanding that not only do resource differentials and the advantages of firms play a role in determining overseas investment activities, but foreign government actions may substantially influence the attractiveness and entry conditions for firms locating their foreign activity. The actions of foreign governments are a factor not addressed in other theories thus far.

This directs us to a related aspect of foreign direct investment, the concept of *internalization theory*. This theory focuses on the fact that firms aspire to develop their own internal markets whenever transactions can be made at lower costs within the firm.

Another critical element was added to the research literature by Caves (1971) and Buckley and Casson (1976) when they noted that it was not only important for firms to possess some advantage in relation to its competitors, but that there was a need to do so through a foreign direct investment verses some other less expensive means, such as exporting, licensing or possibly joint

ventures. The rationale was that there needed to be some economies to internalizing the advantage. What resulted was the theory of internalization of FDI.

This new focus presented a shift from Hymer's work as it looked at barriers to other means of extracting advantages internationally. The role of the multinational in Buckley and Casson's work was that it represented an entity created as a reaction to existing market imperfections as opposed to the view from Hymer that multinationals create or enhance market imperfections. The emphasis from the viewpoint of Buckley and Casson is that the multinational firm can be seen as efficient. This is not something that was noted in Hymer's work.

To date, the internalization theory is deemed to be one of the more generally accepted theories of foreign direct investment. There are however, other complementary theories of FDI. One such theory suggests that firms act to internalize the market to gain some key intermediate input. For example they may vertically integrate to acquire inputs, which cannot be acquired domestically. Another theory indicates that foreign direct investment can be used as a means of risk reduction, if the returns on assets employed in different countries are imperfectly correlated. Still other theories consider that FDI stems from interactions between or among competing firms, in which FDI is part of a firm's strategy in a game of rivalry. Graham (1978,1979) developed a model in which multinational firms invade each other's home base or territories in a series of strategic threats.

### 2.6.1 Internationalization theories of the firm

Hayes and Abernathy (1980) reported that the trade deficit performance of a nation cannot always be explained by macro-economic phenomena, and that the role of the entrepreneur plays a part in explaining the international trading activities of a nation. Given that most economies are comprised of numerous industries, accounting for an array of firms, it is not uncommon to expect that the decision makers within these firms can collectively make a substantial contribution to a nation's economic performance. In contrast to international trade and FDI theories, internationalization theories attempt to explain *how* and *why* firms participate in foreign activities.

One of the major drawbacks resides in the providing an operational definition of internationalization. It has been described as an outward movement of a firm's operations, Piercy (1981) and Turnbull (1985). Welch and Luostarinen (1988) defined it as the process of increasing involvement in international operations, which looks at both the inward and outward growth of international firms. What's important about the Welch and Luostarinen definition is that it takes into account the multiple factors attributed to international expansion. Others have also recognized their definition, because it is a working definition, which is concise and readily interpretable, Young (1990).

A myriad of approaches and perspectives have contributed to the contemporary understanding of firm internationalization. A number of models: economic, econometric, organizational, marketing and managerial have been

formulated that help to explain the structural and behavioral issues underlying internationalization theory, Dalli (1994).

### **2.6.2 Diversification theory**

An important motivation for foreign direct investment is likely to be the desire to reduce risks through international diversification. This motivation may be somewhat surprising because the inherent riskiness of the multinational corporation is usually taken for granted. Risks associated with international firms, which are not normally associated with domestic firms include exchange rate changes, currency controls, expropriation and other forms of government intervention, which increase the level of risk that the firm may experience.

It has generally been hypothesized that multinational corporations provide a diversification benefit to shareholders because they possess cash flows in imperfectly correlated markets (Hughes et al., 1975; and Rugman, 1976). Bartov et al., produced evidence to the contrary, suggesting an increase in systematic risk with internationalization due to greater exchange rate risk. Similar findings were reported in Reeb, et al., (1988) indicating that a variety of risk factors may increase systematic risk such as exchange rate risk, political risk, agency conflicts, or information asymmetry, that can in fact offset the diversification benefits from imperfectly correlated markets. There may be good reason to believe that being multinational may actually reduce the riskiness of a firm. Much of the systematic risk affecting a company is related to the cyclical nature of the national economy in which the company resides. Therefore, the diversification effect due to

operating in a number of countries whose economic cycles are not perfectly correlated should reduce the variability of MNCs earnings, (Cohen 1975; and Rugman, 1976). This corporate international diversification is only beneficial to shareholders if there are barriers to direct international portfolio investment by individual investors.

Risk is unavoidable, although it is definable. Given that risk is unavoidable, the first question for shareholders becomes where will they incur the least amount of risk, while gaining the best return. When assessing where the highest correlation of these two factors will be found, the decision factor is whether the maximization of wealth will take place in the domestic versus the international market. Kwok and Reeb (2000) specifically argued that firms from more stable economies making international investments tend to increase their risks, leading to a reduction in debt usage, while firms from less stable economies making international investment tended to decrease their risks and allowed for greater debt utilization. They based their hypothesis on the fact that the relative business risks among countries influences the risk impact of foreign direct investment. Empirical support by Agmon and Lessard (1977), Fatemi (1984) and Broaden and Samii (2001) posited that the multinational corporate diversification benefit reduces the present value of bankruptcy costs and allows increased debt usage in multinationals.

### **2.6.3 Location Theory**

Location theory, which seeks to determine the optimal location of a firm, owes much to some early researchers in this field such as Weber, Hoover, Loesch

and Isard, Enright (1990). Weber (1929) formulated the problem of location of a firm in terms of cost minimization. He postulated that an industry, or industry in general, will be geographically concentrated if it can obtain lower wage rates, higher labor efficiency, or agglomeration economies that offset the higher transportation costs. Weber classified industries as either “material oriented” or “labor oriented” depending on the importance of materials and labor to total production costs. Weber’s hypothesis is further based on the assumptions that local differences in material costs depend on natural resource deposits and that local differences in labor costs result from differences in wage rates of the differences in the efficiency of labor. The major contribution of Weber’s work was in the recognition that the geographic pattern of production may depend on the location of resources and markets, and the costs of transporting materials, inputs and final goods. Hoover (1937) found shortcomings in Weber’s approach because he felt there was a distinction between localization economies (those gained from proximity of firms in a single industry) and urbanization economies (those gained from proximity of firms in different industries). He believes the former could result from the development of localized skills and suppliers, while the latter could result from the location of inputs and services common to several industries. The approach by Losch (1954) examined industrial location in a spatial monopolistic model. His model assumed a spatially uniform distribution of identical consumers with downward sloping demand curves, transportation costs proportional to distance from seller to buyer, and economies of scale in production. His assumption went further in that, for each product, profit-

maximizing firms would enter until all consumers were served and abnormal profits were eliminated. In Loesch's model, each firm has a local monopoly limited by transportation costs and the location of competing firms. Isard (1956) contributed to the literature by trying to pull existing theories at the time into a general doctrine, and to merge it with existing production, price and trade theory to explain patterns of production. This resulted in the development of a general equilibrium input-output analysis that incorporates transportation inputs in addition to labor, material and capital inputs. Lloyd and Dicken (1977) provide a summary of what might be termed classical location theory literature's contribution to the geographic concentration issue. Spatial variations in production costs and patterns of demand are seen as important influences on industrial location. They also identify economies of scale and agglomeration economies as further influences on the location of industry.

There are several key factors, which could influence FDI location decisions. First of all there is the demand for the multinational's products. If markets were nearing saturation, multinational corporations would be interested in seeking out new markets, in this case the size of the host market and its potential for development become essential. Market size may be difficult to ascertain, however it is not unreasonable to consider the host area's total income, and assume the larger it is, the greater the size of the potential market. The total GDP of the host area could therefore be of some significance in the investment decision process. Another factor is the availability of certain resources, which can be divided into two broad categories: infrastructure and labor. Clearly the better the

infrastructure of the host economy, the more attractive it is to foreign investors. Multinational corporations also have to consider the attributes of the workforce they intend to employ in the area. The concern is mainly with the costs, availability and productivity of the local labor, but also on the strength of unions and their impact on the local labor force. It has been noted in some empirical studies that high labor costs are likely to deter FDI. There can be a countering factor in that higher labor cost may be offset by higher productivity.

Multinational corporations must also consider any government restrictions. Any restriction that deters multinational corporation exports will probably result in the MNC substituting the latter of local production (or FDI). Therefore the more restrictive tariffs and non-tariff barriers are, the more inward FDI there is likely to be. This has been noted in the creation of the EEC common external tariff, which appears to have encouraged FDI flows into the EEC.

#### **2.6.4 Summary**

Table 2.1 summarizes reasons why firms invest abroad based on trade theories, foreign direct investment theories, internationalization of firms, diversification theory and location theory. Each of these research areas contributes greatly to a firm's reasoning for international investment. Firms may invest for one or many of the reasons outlined in the various theories. As they move along the international expansion learning curve and as their competitive position changes in the market, so may their reasons for continued international expansion change. Each of these categories serve as independent research topics,

with their own individual supporting empirical data, it should be noted that there might be some overlap in the attractors sought from each category.

**Table 2.3 Summary of Theories Influencing International Investment**

<b>Categories</b>	<b>Types of Theories:</b>	<b>Key Factors in locating abroad:</b>	<b>Attractors sought:</b>
<b>Trade Theories</b>	Export-led growth theory Classical trade theory Factor-proportion theory Product life cycle theory	Distance Competitive capabilities Cultural similarity Relations between countries Business cycles	Large markets Natural Resources Cheap labor (both unskilled and semi-skilled)
<b>Foreign Direct Investment Theories</b>	Market imperfections theory Industrial production theory Internalization theory	Capitalizing on capabilities not shared by competitors. Comparison of resource availability and capabilities in the home country with those in the host country.	Deregulated markets Reduction in trade barriers
<b>Firm Internationalization Theory</b>	Outward movement of a firm's operations. Increasing international operations (inward and outward).	Structural and behavioral factors: Economic Econometric Organizational Managerial Marketing (Promotion)	Political, economic stability Ease of entry, exit Welcoming environment for investment Transparent regulatory framework
<b>Diversification Theory</b>	Risk and Return Theory Portfolio theory	Higher ROI and lower systematic risk. Greater debt utilization.	Uncorrelated markets
<b>Location Theory</b>	Agglomeration Theory Cluster Theory	Resource availability (Labor and materials) Government intervention (related to export barriers)	Market size Skilled and productive workforce

From the above information, several reasons for investing abroad have been noted and some basic country attractors, which have been sought, have been identified. To this point, generalizations have been presented for foreign

investments by DCMNCs. In the next section, firm behavior within the scope of FDI theories is discussed.

## **2.7 Transnational Behavior Within the Scope of Foreign Investment Theories**

While there is a generous amount of writing on the causes and explanations of foreign investment by MNCs, the concentration that will be established here is on DCMNCs and their relation to developing economies. As noted earlier in the thesis, in the present international economy, direct foreign investment is mostly the impact of large firms operating in monopolistic or oligopolistic markets. In examining the behavior of the major MNCs, and quite possibly the cause of foreign direct investment, it is important to analyze the nature of the factor and product markets and the internal structure of the firms that do the investing. There are two types of “pure” economic theory – that of international trade and that of the orthodox theory of the firm – which in their “rigorous” neoclassical form may be relevant to the analysis of foreign investment, Lall and Streeten (1977).

In a pure theory of international trade, most notably the Heckscher-Ohlin model, the assumption is perfectly competitive markets, identical production functions in different countries and international movements of capital in response to differences in interest rates. The general premise is the firms from advanced economies (those which are capital-rich) invest in developing or emerging economies (those that are capital-scarce). This theory does not provide an adequate explanation of reverse investment, as the firms from developing

countries cannot be considered capital rich for the most part, and their production processes are not necessarily identical in the different countries in which they would invest. It should be noted that the pure theory of international trade has been deemed to be somewhat flawed in its explanation of foreign direct investment in that it does not include a full explanation, which excludes such explanations such as foreign borrowing or portfolio investment, the growth of firms that possess considerable monopoly power or of the transfer of other factors of production like technology, management or marketing.

Moving to neoclassical theory, this theory has attempted to fill the gap of the pure international trade theory, by accommodating the realities of transnational investment. Under this “pure” orthodox theory, it is assumed that firms are in perfect competition (suggesting that they have equal access to factors of production, do not exercise market power, and they would reach an optimum size set by long-term diminishing returns to scale). This theory also has some drawbacks to explaining the foreign investment behavior of DCMNCs. To begin with, it is not useful in explaining DCMNCs that grow in extremely imperfect markets, or those that do not show signs of having reached limits to their growth, or which may have been subject to various interdependencies. What this theory calls into question is whether firms need to be of a certain size and possess certain advantages in order to invest abroad successfully. Earlier it was mentioned that the largest DCMNCs were of a smaller scale than their counterparts, MNCs. In referencing back to the list of top 50 transnational corporations from developing countries included with this study, it can also be seen that size, in terms of scope

of operations, there are varying degrees found within this list, from those in a few locations (*Barlow Ltd, Citic Pacific Ltd, Singapore Airlines, etc*) to those with a very broad expanse (*Daewoo, Creative Technology Ltd, Acer, YPF SA, etc*).

These two factors may signal that the theory is somewhat deficient when applied to DCMNCs. There is a portion of the theory, in relation to profit maximizing behavior, that may in fact be relevant under certain modifications.

Recent theories of foreign direct investment, particular those dealing with the growth of transnational corporations, have turned to explanations based on “imperfections”, oligopolistic interdependence and the possession of monopolistic advantages. Often referred to as oligopolistic explanations, in reality these theories draw upon a variety of different fields of study, such as: new theories of the firm, monopolistic competition, industrial structure, location, and innovation. The general concept of the oligopolistic theories is that firms operating across national boundaries, as well as over long distances suffer a disadvantage, caused by issues of asymmetry – difficulties of communication, cultural differences, lack of knowledge of local market conditions, and other factors affecting the firm’s operations. The key issue is that for transnational investment to be profitable, these activities must be offset by a special or unique advantage for the transnational firm over local competition. Under conditions of perfect competition, no single firm can, based on assumption, have access to any kind of special or unique advantage that is not equally available to other firms that do not suffer from the kinds of disadvantage associated with the transnational corporation. If this is the case, then direct foreign investment cannot take place in

this situation. Therefore, a necessary condition for direct investment relies upon the investing firm to have some monopolistic or oligopolistic advantage not possessed by local competitors. The question then becomes whether firms from developing economies possess either oligopolistic or monopolistic advantages over the local competitors in the markets in which they make the direct investments. In order to answer this, it is important to examine specific factors, which would contribute to a DCMNC having or creating an oligopolistic or monopolistic advantage.

There are several sources from which an oligopolistic advantage can be created, and four of these sources will be considered. First, there is the consideration of capital. Does the foreign investor possess a larger or cheaper source of capital than a local competitor? Several reasons have been suggested for this: (1) the firm may hold large internal resources for which its opportunity cost in terms of alternate possibilities may be low; (2) it may have access to capital markets in developed or more developed, that may not be available to, or at least it may be more costly for local competitors; and (3) or it may gain more favorable terms in raising capital locally, due to its favorable credit rating or the fact that there may be branches of transnational banks with which the firm has a priority relationship. The location of the investment and the size of the firm will be important factors in terms of access to capital. Some DCMNCs are large enough to be listed on major stock exchanges, which would allow them access to capital in those locations. Others, for the most part are not large enough to have that advantage. There are for example firms from Hong Kong, that have been

able to penetrate the Canadian market due in part to the fact that the Bank of Hong Kong has several branches throughout Canada and they have been supportive of Asian business expansion. Having capital provides an advantage in terms of being able to expand, therefore it serves mainly as a permissive factor in foreign investment. It may provide the needed resources for a firm's participation in a joint venture or quite possibly an M&A activity, which as noted earlier are alternative expansion techniques for DCMNCs. It does not seem reasonable, however, that in the absence of other oligopolistic factors a firm would consider a direct investment.

Another oligopolistic advantage often considered by MNCs is exchange risk. Because of the existence of exchange risk and the hardness of the currencies of capital-exporting countries, the pattern of direct investment reflects that the source country firms capitalize the same stream of expected earnings at a higher rate than host country firms', partly due to the fact that the market demands a premium for bearing uncertainty about exchange risk, and partly because the market does not attach a currency premium to the foreign income of the source firm, Aliber (1970). This in fact may be valid for direct investment in developed countries, by firms from developed economies, however it does not seem to be relevant to direct investment in developing economies, especially those with highly imperfect or non-existent capital markets and heavily regulated foreign exchanges. It would also seem that this does not apply to reverse investment.

The strength of the firm's management may be an advantage that takes the form of either greater efficiency of the operation or of a greater entrepreneurial

ability to take risks. Many DCMNCs are small in size and smaller firms frequently must ally themselves with partners in order to make international expansion feasible (e.g. employing an export agent, licensing, joint venture or strategic alliance strategy), Zacharakis (1997). The alliance of two distinct entities central to these strategies lends itself to a transaction cost perspective. In order for this to be an advantage and for both parties to benefit from the relationship, each must contribute some specialized knowledge that the other is lacking; or as Lawless and Price (1992) assert, each party must possess asymmetric information.

Technology is another area of consideration. The firm may possess superior technology<sup>5</sup>. The production of technology, as measured by R&D expenditures, is highly concentrated in the developed countries, particularly the USA, and it is highly concentrated within a few firms, particularly transnational corporations. These transnational firms are responsible for the bulk of marketable innovations in the developing economies. The focus has been on discovering new processes (more efficient ways of doing existing jobs) and new products (more efficient ways of meeting market needs). MNCs are also a vehicle of technology transfer to developing economies, which is often the means of promoting economic growth in these nations. In assessing the behavioral aspects of a firm, this is often considered or classified as an offensive innovative strategy. It is not just in the area of new products that technology is applied. A considerable

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<sup>5</sup> The definition of technology used here is taken from Lall and Streeten (1977) which states, not the knowledge of the relevant sciences, which may be available in some disembodied form more or less equally to all countries, but the ability to translate the knowledge into practical, commercial use.

amount of technology is directed towards the introduction of slight modifications (in presentation, appearance and performance), which is viewed as product differentiation. As the manufacturing industry grows more oligopolistic, particularly where technologies mature, the role of R&D directed towards product differentiation becomes more important. Freeman (1974) notes that most industrial R&D is defensive in character, concerned primarily with short-term horizons and improvements. Defensive R&D is most typical of oligopolistic markets and is closely linked with product differentiation. Several industries with heavy R&D expenditures tend to concentrate on product differentiation R&D. The automotive industry is a prime example of this. Other industries such as pharmaceuticals, engage in differentiation to extract the maximum benefit for basic R&D and genuine innovations, Lall (1974, 1975). When it comes to technological advantage, MNCs have sought several types of advantages: (1) where the minimum scale of R&D is very high and there are economies of scale involved only the very large firm will be able to undertake it successfully; (2) where the technological threshold is not high, but an extensive marketing framework is needed to sustain a stream of innovations, large size and widespread outlets will be a central advantage; (3) where continuing R&D needs outside financial support, again large size tends to be of vital importance; and (4) where the success of a major innovation requires complementary technological advances in related industries, and where the preservation of existing technologies calls for control of competing technologies, large size may have an enormous advantage in terms of coordination of technological activities and of investing in the firms or

industries concerned. In regards to DCMNCs, for the most part, they are not considered to have the magnitude of their advanced economy counterparts. Some DCMNCs in fact are quite large, with two, Daewoo and Petroleos de Venezuela, considered large enough to be considered on the top 100 list of transnational corporations in the world. These companies and possibly a few more of the larger DCMNCs may have the capacity to create a technological advantage, however, few others are in contention for such distinction. Therefore, technology may not be considered an oligopolistic advantage of the majority of DCMNCs.

An area that has been considered absolutely vital to international investment is that of marketing, and this perhaps constitutes a source of oligopolistic advantage much greater than that of technology. There are several functions related to marketing activities such as market research, advertising and promotion, and distribution. Market research enables a firm to gain an understanding of the buyers' needs as they evolve in the various markets. Most critical is the imparting of information and the reinforcement of demand for the firms products or brands. Where marketing can promote the brands of particular firms successfully, this can serve as a powerful inducement to international expansion. It has been noted earlier the disadvantage that DCMNCs often have in promoting their products in advanced economies, particularly due to country of origin factors. This may not be as much of a factor in developing economies as the close proximity of developing nations may overcome some of the information asymmetry associated with foreign made goods. Similarly, when distribution (the arrangement for getting products efficiently to their markets) is considered to

advanced economies, DCMNCs, due to high transportation costs and lack of network contacts, may find this to be a disadvantage as well. Consequently, if the proper infrastructure is not available in the developing nations, DCMNCs may not gain any advantage in this situation as well.

Access to raw materials is another source of advantage for firms. Foreign firms may have privileged access to raw materials or minerals, due to their control over the final markets or the transportation of the product; over processing activities; or over the production of the material itself. MNCs may have obtained this advantage based on several factors; historical, where privileges might have accrued based on colonial rule; technological (particularly when processing and mining are complex and capital intensive); financial, where the capital requirement to access new raw materials may be particularly large (for example in mining); and marketing related, with the final products being dominated by brand names or retail chains. This last advantage, marketing related, can often be traced back to one of the other advantages mentioned previously. However, while these actions may turn out to be advantages for MNCs, conversely, these same activities often turn out to be disadvantages for DCMNCs.

An additional area that has been considered to provide monopolistic or oligopolistic advantage is in economies of scale. The literature referencing barriers to competition has noted that economies of scale to be an important source of market power for large firms. In regards to international investment, if certain facilities enjoy scale economies, this factor will work to the advantage of those firms, which have the finance and expertise to set up and operate such

facilities. Scale economies, those arising from the “traditional” scenario of size of plant, or of the more recent type, based on multi-product plants, gain economies through longer production runs, and these advantages are available to all firms that can reach the requisite size. Economies of scale do not create any special source of market power, unless the large size can be attained only by having access to some other special advantage, such as technology, marketing or access to capital. Firms have grown more by using multiplant operations, than by increasing the size of their plants. The focus has been less on the technical advantages of large plants, but rather on the centralization of activities like R&D, marketing, finance and managerial expertise, which in fact due yield advantages to large firms. Basically, scale economies serve mainly as a permissive factor in overseas production, for both MNCs and DCMNCs.

A final area to consider in monopolistic or oligopolistic advantage is in a firm’s bargaining or political power with a host government. Many MNCs maybe better able to receive concessions or favorable terms from host government than local firms for several reasons. To begin with, they may possess some scarce resource, such as capital or technology, which local firms do not possess. Secondly, MNCs may benefit from pressures exerted by the governments of their home countries (through aid program, diplomatic or political links) or through pressure exerted by interested groups or officials in host countries, who are promoting foreign direct investment activities.

Beyond considering monopolistic or oligopolistic advantages, there is the consideration of a diversification benefit accrued to international expansion.

Previously discussed was that MNCs desire to reduce their risks through diversification activities, however, it has been noted that MNCs may incur other risks not inherent with domestic operations. These risks are often offset by a MNCs entry into multiple locations, assuming different business cycles prevail. DCMNCs are also inclined to want to accrue the benefits of diversification.

And finally, there are location theories and whether they provide an advantage for international investment. Early research indicated that MNCs would seek locations that provided a cost minimization benefit. Later research began to focus on the demand for a firm's product, which made market size a key attraction. Additionally, resources become a major focus. In particular, infrastructure and labor become essential advantages. Government restrictions as well as incentives are also key attractors. Porter (1990) shifted the focus somewhat and began to emphasize the importance of industries, governments and research institutions forming "clusters" to provide an advantage to those firms choosing to locate in and around each other to benefit from each other's technological capabilities. Like MNCs, DCMNCs find location activities to be advantageous as well.

To determine if these theories do in fact apply to DCMNCs, the firms will be examined in both advanced and developing economies based on the effects that "*producer environments*" have on the DCMNCs. At this point it is time to examine the theoretical framework for reverse investment from the viewpoint of the factors resident in a producer environment that will drive a DCMNC to another economy and those factors that attract a DCMNC to a different economy.

### 3. Chapter Three - Theoretical Development of Reverse Investment

#### 3.1 Introduction

The development of reverse investment theory in this thesis is examined based on two general concepts: “*restrictive producer environments*”, those environments which limit or constrain the ability of firms to sustain competitive advantage created by factors inherent in the firm's internal environment, forcing developing country multinationals to look for opportunities outside their home borders and “*receptive producer environments*”, which are environments that complement the competitive advantage created by the firm's internal systems and resources, providing it with resources in the external environment to maintain competitive advantages. These producer environments often create “push-pull” influences on the firm's ability to operate successfully in one particular country's environment verses another.

Figure 3.1 illustrates the process of push-pull effects that emanate from both restrictive and receptive producer environments on firm activity and globalization. Since the focus is on firms in developing economies, the "push" factors are limited to factors from developing economies only. The factors that "pull" a firm to either advanced or developing economies may be dramatically different depending upon the economic environment into which the firm is being drawn. To some extent, this is dependent upon the firm's actual core competencies, the primary industrial sector in which it operates, the experience level of its management team and the attractive features that can be found in the receptive producer environment.

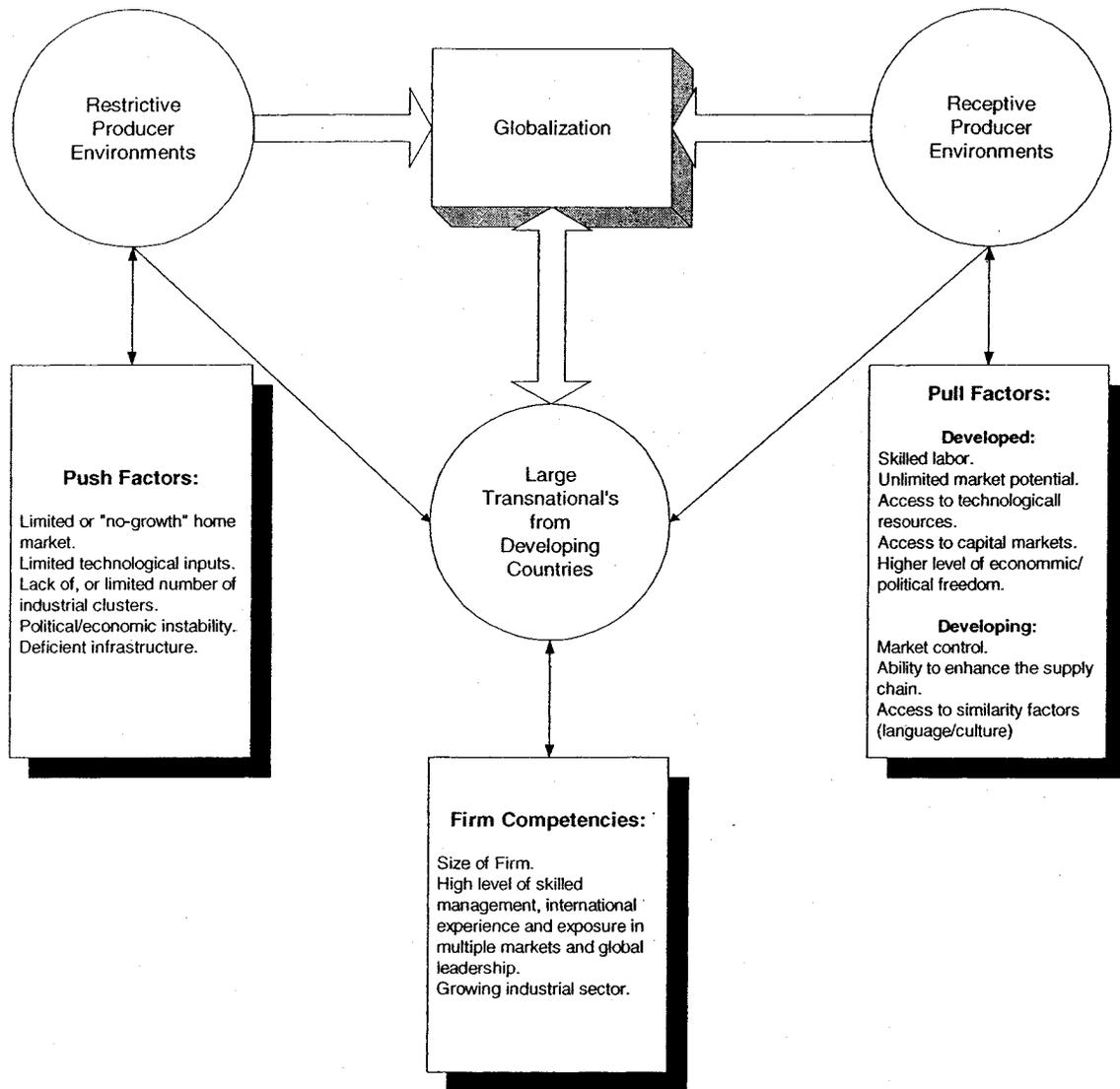


Figure 3.1

To understand the effect of push-pull activities on developing country multinational firms, it is important to first examine the environment in which these firms operate. This is done by first examining the concept of a general producer environment for firms from developing economies.

### **3.2 Typical Producer Environments for DCMNCs**

The market structure of many developing country firms is based on the fact that the government was the primary producer. In these economies, primary producers rule. Control over markets and market activity was essential and government's were the medium of control in the early stages of industrial development. States in effect replaced the market. They had ownership rights to just about everything, such as; land and mines, industrial factors and communication systems; banks and insurance companies; as well as hospitals and schools. Non-governmental producers struggled to find a competitive position in the market. As privatization programs began to emerge, governments and private sector firms began to share the producer role in the economy.

During the late 1970s through the early 1990s the level of SOEs declined rapidly in number, particularly in Asia, Africa and Latin America. Those remaining tended to be large monopolistic firms, which controlled either an abundant source of natural resources, such as petroleum or they controlled major utilities and communication systems. Private firms in the environment varied from small-to-medium sized domestic firms, which typically made up the majority of firms in developing economies; large developing country multinationals that have been continuing to grow in size; and large multinationals from developed countries. The latter are not the major focus of this thesis. Producer environments vary over time. These variations can be attributed to economic, political, technological or social shifts in the environments. Firms in

all the categories listed above enter and exit for a variety of these reasons. Figure 3.2, portrays a typical producer environment.

### A Typical Producer Environment in Developing Countries

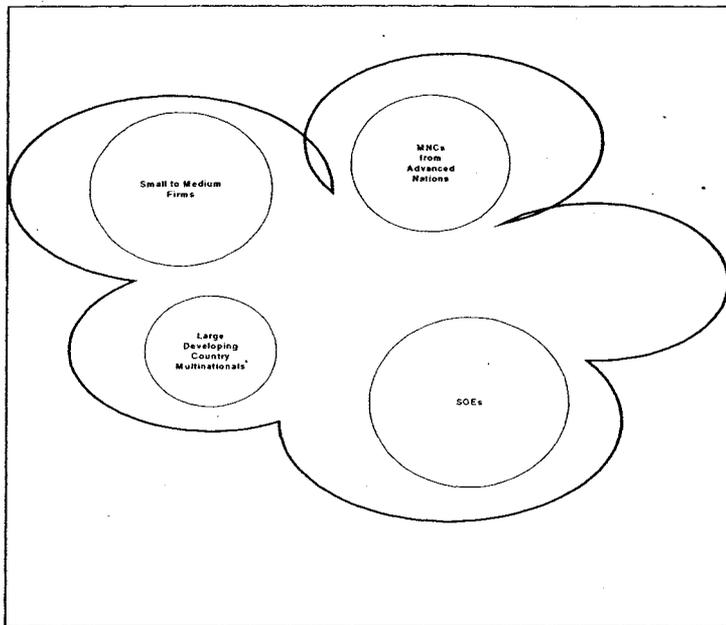


Figure 3.2

The scope of these domestic markets is often limited in terms of market size. Given the limitation of the market size of many developing countries, and the variety of producers competing for resources within the environment, large multinational firms (both private sector and government owned) who find themselves engaging in international expansion to accomplish their particular firm objectives, are often "pushed" from their current producer environment when elements in the environment are in conflict with the accomplishment of their strategic goals. In contrast, DCMNCs are drawn or "pulled" into those producer

environments, which offer attractive features in support of firm specific objectives.

Large multinational firms from developing nations are often characterized as firms coming from labor-intensive industries. From the table below, a number of labor intensive industries make of the composition of the top 50 DCMNCs, which include such major industries as: food and beverage; construction; petroleum; steel and iron; pulp and paper; and tourism and hotels. In line with the theory of factor production, these developing country multinationals are generating and exporting goods and services in line with the abundance of natural resources and skills available to them in their home country environment. As DCMNCs grow in size and market sophistication, as an outgrowth of their use of technological innovations and managerial experience, the home environment may not provide the essential elements for growth such as a more advanced These industries often comprise a majority percentage of the GDP of their countries; while competing firms from advanced nations may not find that these industries provide comparable percentages of their home GDP. This can often pave the way for these DCMNCs to expand internationally.

A comparison of the industry composition of the top 100 transnational corporations from developed economies and the top 50 transnational corporations from developing economies shows the changing magnitude of participation in various industry sectors by these two groups.

**Table 3.1 Compositions of the Top 100 MNCs and Top 50 DCMNCs**

Top 100 Transnational Corporations (Developed)				Top 50 Transnational Corporations (Developing)			
Industry	1990	1997	1998	Industry	1990	1997	1998
Electronic/electrical Equipment/Computers	14	18	17	Electronic/electrical Equipment/Computers	7	4	4
Motor Vehicle/Parts	13	14	14	Motor Vehicle/Parts	-	-	-
Petroleum exploration Distribution & mining	13	13	11	Petroleum exploration Distribution & mining	3	5	5
Food Beverages/ Tobacco	9	8	10	Food Beverages/ Tobacco	7	7	8
Chemicals	12	8	8	Chemicals	1	2	1
Pharmaceuticals	6	13	8	Pharmaceuticals <sup>6</sup>	-	-	-
Diversified	2	7	6	Diversified	12	16	11
Telecommunications	2	4	6	Telecommunications			
Trading	7	3	4	Trading	-	-	3
Retailing	-	1	3	Retailing	-	-	-
Utilities	-	-	3	Utilities	1	2	3
Metals	6	-	2	Metals	-	-	-
Media	2	1	2	Media	-	-	-
Construction	4	3	1	Construction	4	6	6
Machinery/engineering	3	2	-	Machinery/engineering	-	-	-
Steel and Iron	-	-	-	Steel and Iron	5	-	3
Transportation	-	-	-	Transportation	1	4	3
Pulp and Paper	-	-	-	Pulp and Paper	2	2	1
Tourism and Hotel	-	-	-	Tourism and Hotel	3	1	1
Other	7	5	5	Other	4	1	1
Total	100	100	100	Total	50	50	50

Source: UNCTAD World Development Report, 2000

As noted in the chart, MNCs in both the petroleum and food and beverage industries have a larger total number of firms; the DCMNCs are in fact increasing in number in these sectors. In the areas of construction, steel and iron, transportation, pulp and paper and tourism, MNCs have either a declining presence or no presence at all. In situations, which MNCs in competing industries have diminished their level participation; large DCMNCs enter those markets seeking a competitive advantage through market seeking activities, often translating into market power for a number of the firms. These firms often have competitive advantages similar to oligopolistic firms found in advanced

<sup>6</sup> Due to the small number of firms in the chemical and pharmaceutical industries, along with the fact that some of these firms participate in both industries, the number for both sectors are included in the Chemical industry listing.

economies. Next, the restrictive producer environment concept is examined in detail.

### **3.2.1 Restrictive Producer Environments**

The size of most developing country markets for manufactured goods is often on a smaller scale than that of many advanced nations. To a great extent the income levels of consumers in the immediate market and target market(s) in which goods are sold influence this factor. Producers produce goods based on the demand requirements of the market. The more advanced nations, particularly in North America and Western Europe, tend to have higher incomes per capita versus most developing nations. American firms were strong in producing high income, labor saving products. This was one of the reasons that the appliance industry was an essential and profitable sector for American businesses. While incomes in European countries were not at the same level as those in the United States, they were still higher than most developing countries. Large transnational firms from developing economies must somehow find alternative markets, which can accommodate the products they are producing, based on the scale of their operations. This becomes a major push factor for these firms in terms of international investment.

Lack of technology becomes another push factor for firms from developing economies. Often, the field of expertise of the developing country investors is not concentrated in the “high technology” industries. This is by no means meant to imply that the large firms from developing countries do not incorporate a level of technology into the industries in which they operate,

because they do. However, the advanced nations provide an even greater level of technology due to their ability to invest more heavily in research and development activities than smaller firms are able to expend. As the major of large transnational firms from developing countries are concentrated in labor intensive industries, the amount spent on technological innovations is more limited as they tend to take advantage of more inexpensive labor costs. This leads to another factor that drives DCMNCS to expand abroad, and this has to do with the clustering of competitive firms in an industry and in a particular location. When conditions in the market make it attractive for firms to exploit a competitive advantage, other firms within the industry will be drawn to the nation in hopes of benefiting from the technological spillovers created by the other firms. There is also the intention of obtaining market share in an area which is promoting growth in a particular industrial sector. Competitive industries in a nation are not usually evenly distributed in the economy. A nation's successful industries are often linked through vertical or horizontal relationships. Firms benefit from this type of competitive arrangement as they have access to innovation and information due to the linkages that are created. When nations are unable to create this competitive environment, firms seek other locations where competitive capabilities can be utilized.

However, in addition to the reasons stated, there are some basic fundamental issues why firms are pushed from one nation to another. Political upheaval, unstable economic factors (high taxes, high inflation, devaluating currencies), and underdeveloped infrastructures (physical and structural) can also

force firms to invest in more advanced economies. Take for example the case of San Miguel Corporation, one of the largest food and beverage companies in the Philippines. The political and economic environment in the Philippines has gone through some tumultuous cycles. When US brewing giants Anheuser-Busch and Miller Brewing Co. sought to enter the Philippine beer industry, hoping to take advantage of the unstable economy, they were not prepared for the local competition posed by San Miguel Corporation. San Miguel had securely positioned itself in its domestic market, but the market was not developing at a fast enough pace in its home country and it needed to find other markets in which to compete. San Miguel thrust itself into the international arena began by participating in intense beer licensing and exporting. Basically, its exporting efforts increased by 150 percent in the late 1980. The strategy to use licensing and exporting was done to create brand awareness, as its major target markets were Asia, the US, Australia and the Middle East. Once brand awareness was established, the company moved to build production facilities, some on an independent basis and others through an indigenous joint venture partner. These markets were larger in size than the Philippine home market providing expansion opportunities for the company.

A similar situation occurred with South African Breweries. After years of apartheid, and the country embarking on restructuring and privatization programs, the firm had worked diligently to position itself as a major brewery and accomplished this task despite the fact that it has a limited domestic market. It gained global exposure initially by entering the European, Asia and other African

markets. It recently sought entry into the high-income market of the US and did so in a major way, by acquiring the third largest domestic US brewery, Miller Brewing Co. Miller located in Milwaukee, WI, is located in what was once known as the beer capital of the world. While some of the former leading breweries in the area have been acquired, there are still a number of microbreweries in the area. This clustering of firms within the industry provides opportunity to gain from technological and innovation processes in the beer industry.

Governments, which are a critical factor in the economic development of their nations often have a major impact on whether firms are encouraged to stay within a particular producer environment or are driven to other nations borders in search of opportunity to sustain their competitive advantage. Governments in developing countries, and sometimes in advanced nations, subsidize industries that can contribute to the nation's economic well being. Subsidizing and promoting certain industries over others can draw critical resources to one industry and away from another.

As developing economies become more industrialized and privatized, the wage scales in their countries tend to increase as well. More industrialized firms need higher skilled workers and these workers require payment in accordance with the work that is being performed. As private investors take over more state-owned enterprises, they recognize the need to pay market wages in order to gain productivity efficiencies. However, even those labor-intensive industries that have built technological improvements into their operations are still dependent

upon having a large labor force to support their production processes. They often enter other developing markets to accomplish this task.

An additional factor that drives or pushes firms from their home country is access to natural resources. Firms from developing countries are often in need of key resources that are not available in their own home countries to support their manufacturing processes of another product. For example, the Korean firm, Ssangyong Cement Industrial Co., the parent company of one of South Korea's largest chaebol's, which has diversified holdings in oil and heavy equipment, needed a source of oil in order to assist in fueling the company's cement plants shortly after the oil crisis back in 1973. Partially at the direction of the Korean government for its chaebol's to become more internationally competitive, the firm entered into a joint venture agreement with the shah of Iran and was able to establish an oil refinery that accomplished both the government's and the firm's goals.

Stronger factors within the developing country environment have shown that they create a major push on firms to enter developed and other developing markets. Currently, there is no evidence in the literature to suggest that the factors that drive DCMNCs from restrictive producer environments are unique only to them and do not affect other firms that may exist in the DCMNCs home country. But are these firms pulled into these "receptive producer environments" in both developed and developing countries for the same reasons? In the following section pull factors from both a developed and developing country perspective are examined.

### **3.3 Receptive Producer Environments**

Significant world events, such as world financial crisis', changing regional economic structures (i.e. creation of the European Union), control over limited natural resources (oil crisis, 1973 and 1980) and shifts in political leadership all impact the rate and direction of capital flows, and have dictated that countries are in constant competition with each other to attract direct foreign investment. From the mid-1970 to date there has been a changing geography of FDI, and MNC activity. For the 1975-1980 period, global FDI inflows received by the developed countries totaled 77 percent, 23 percent by the developing countries and 0.1 percent by Central and Eastern Europe. Corresponding percentages for the 1991-1996 periods show 64 percent, 33 percent and 3 percent, respectively, (UNCTAD, 1997). Much of the decline in the developed countries can be attributed to the slowdown in the US economy. Growth in Europe broke through the 3 percent barrier for the first time in over a decade. With interest rates falling in the US and the prospect of recovery of the euro, which should ease the pressure on monetary policy, Europe seems well placed to take on global economic responsibilities and boost global demand, thus offsetting the effects of a slowdown in the US.

From the perspective of developing countries (as well as developed countries), there are several influences that have been and will continue to be important in understanding the attraction of FDI flows. Basic among these influences are political and economic stability and an inviting environment for FDI, as well as the development of private enterprises. Beyond these basic influences, there are additional factors, such as: the ease of entry and exit,

appropriate standards of treatment and dispute resolution, along with a predictable and transparent regulatory framework. These general requirements make up the basic investment attraction.

There are however, unique pull factors that exist for developed and developing economies that aid them in attracting foreign direct investments, which will be discussed in detail. As noted in figure 3.3, diverse factors pull DCMNCs to both developed and developing economies.

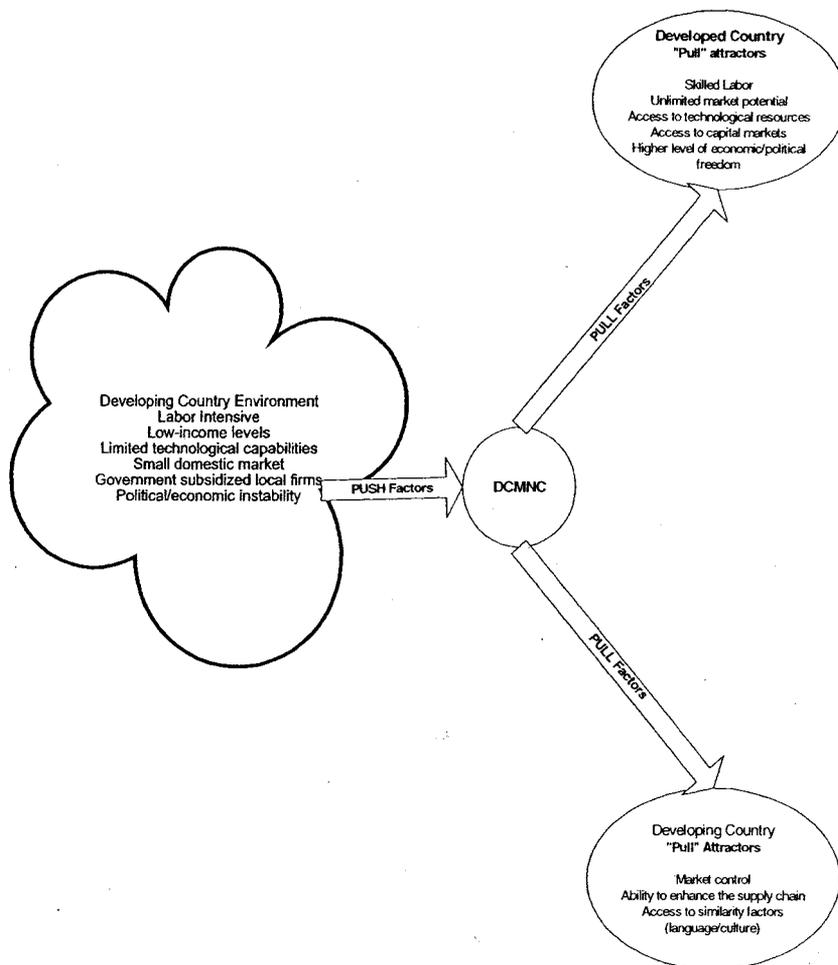


Figure 3.3

### **3.3.1 Pull Factors in Developed Receptive Environments**

Developed countries are able to attract large DCMNCs because of the size of the market in the host country. There are however, some difficulties to the firm in order to secure a part of the vast market, which is available. Even when developing country firms produce quality products at home, an essential element needed for success in a foreign market is the ability to have the marketing know-how to gain acceptance of the product. Some firms develop a marketing advantage through special relationships at home with a small number of important customers or they seek out niche markets initially to gain a foothold in the market. Changing demographics and the appeal of healthier dietary requirements has made the ethnic foods market in the US food and beverage industry, and attractive opportunity for many developing country firms that specialize in these products. For large DCMNCs that find themselves competing with small operations in their home market that are licensed and subsidized by local governments, the pull to a larger market, is quite appealing. Grupo Industrial Bimbo found that its market for packaged foods was much greater in the United States than in Mexico for these very reasons. The subsidizing of local firms can be seen as a disadvantage; however, one of the additional attractors to developed markets is access to their capital markets. While Bimbo did not seek financing from US capital markets, its initial foray into the US market, through an acquisition of Pacific Pride Bakeries, San Diego's largest independent baking company, did coincide with a \$130 million in financing from the International Finance Corporation (IFC). This type

of financing scheme may not have been possible for the company in the local market.

Marketing is a key attractor in developed markets. With few exceptions, brand name has not been a major competitive advantage for most developing country firms. San Miguel Corporation can be singled out as one of those exceptions. The company is well known internationally, and has established a chain of breweries outside of the Philippines. However, much of the marketing success may need to be attributed to the unique characteristics of firms in the beer industry. In contrast to most other industries for which product differentiation plays a major role, multinational firms from the industrialized countries are virtually absent from the world market in this industry. For most other developing country firms, they gain a marketing advantage through ventures with host country partners. Wells (1983) noted that small to medium sized firms entered the market through minority ownership positions with joint venture partners. For large DCMNCs, they are more apt to hold majority ownership positions in joint ventures.

Large firms from developing countries will be drawn to environments where other competitive firms in the industry are operating. Competitive industries often attract firms that believe they have a competitive advantage over other rivals. This clustering of industries is often the result of a national competitive advantage that a nation creates through mutual cooperation with government, industry and research institutions. The result is an innovative and technological climate, which allows firms to further advance their competitive

advantage. Porter (1990) noted that the phenomenon of industrial clustering is so pervasive that it appears to be a central feature of advanced national economies. The ability to access technology is a key attractor for large firms from developing economies. Korea's Ssangyong Cement Industrial Co. competitive advantages are a double-edged sword. First, the company realizes that it must stress after sales service to its customers, before advertising, as it seeks to build brand awareness. Secondly, it invests heavily in research and development to enhance quality and innovation. In order to maintain these competitive advantages it must operate in an environment where others challenge it to maintain its competitive capabilities.

### **3.3.2 Pull Factors in Developing Receptive Environments**

Entry into other developing country economies by large DCMNCs can be done for market control factors. Control comes from the competitive advantage that the firm will have over local firms. Large DCMNCs may find that they have oligopolistic advantages in other developing economies, especially if these firms are considered leaders in their particular industry as many of the top 50 transnational firms from developing economies have become. One form of control that they possess can come from access to sources of capital not available in the local market. The foreign investor may possess a larger or cheaper source of capital than the local competitor, simply by virtue of the strength of the parent company. This access can come from three basic areas: the parent may possess large internal resources, which may mean its opportunity costs in terms of

alternative external sources may be relatively low; if the parent has subsidiaries in advanced nations, it may have access to capital markets, though either loan or equity activities, that may not be accessible to the local competitors or if accessible, it may be more costly; and or it may obtain favorable terms locally or a priority in raising capital locally, due to either favorable credit ratings or initiatives by governments to entice specific industries into its economy.

Additionally, firms are drawn to low cost factors of production, such as inexpensive labor and materials that are available in these markets. These competitive advantages have been attracting MNCs to developing countries and large DCMNCs find these elements to be beneficial as well.

However, access to capital and low cost factors of production may not be enough of a factor to provide control over local competitors. Often firms are drawn to other developing countries where there are similarities in languages, cultures and products specifically designed for common markets. This is noted particularly with DCMNCs from Latin America. Cemex SA de CV, the largest cement producer in the Northern Hemisphere and the third largest in the industry, has an extremely large international scope which spans 22 countries, with major subsidiaries in Mexico, the United States, Spain, Venezuela, Panama and the Caribbean. Its primary markets are those in great need for infrastructure and a growing demand for housing. Cemex's market dominance is felt throughout the entire global construction industry. Its success is due in part to the language and cultural similarities that it shares with some of its major Latin American markets. Its success in the US market is partially attributed to its close proximity and

language/cultural similarities within a mini trade zone between Northern Mexico and southern Texas, California, Arizona, New Mexico and Florida. Its success has also been attributed to its ability to take advantage of low cost production.

Push and pull economies have a dramatic impact on a large DCMNCs decision to make an investment abroad. However, there is still the issue of what causes firms to make international investment. In the next section, the firm's competencies are examined in order to address this issue.

### **3.4 Firm Competencies for International Investment**

Having certain competitive advantages might explain how firms can compete in foreign markets, but all firms with competitive advantages do not choose to invest in overseas markets. Firms need to have specific characteristics that provide them with the necessary competencies to survive in foreign markets. The size of the firm is a major contributing factor. Large transnational corporations from developing countries have developed substantial levels of assets, sales and personnel. For five years, since 1995, two developing country transnational firms, Petroleos de Venezuela (Venezuela) and Daewoo (South Korea) qualified for entry on the world's top 100 transnational corporations list. Daewoo missed entry on the list in 2000 when it did not meet the \$6.8 million threshold for entry, (UNCTAD, 2000). These and other gigantic firms from within the developing world are critical engines of growth and transformation, as well as becoming a key mechanism for the transfer of capital, technology and management skills, within and between developing and developed economies.

The increasing number of foreign subsidiaries that DCMNCs have accumulated has also impacted their size. More importantly than size is the experience they have gained through the internationalization process. With each additional foreign subsidiary, the firm increases its managerial expertise and knowledge of the global market. Part of the managerial expertise of some of the developing country firms is attributed to their leaders obtaining management training from universities in advanced economies. Cemex's Lorenzo Zambrano, a Stanford University MBA graduate and Ssangyong's Kim Suk Won, who received his formal education at Brandeis University, are examples of leaders education in advanced economies. The leaders are well versed in advanced nation business techniques and are able to transfer this knowledge into their organizational structure.

It was noted earlier in the thesis that the top developing country firms are concentrated in labor-intensive industries. These large firms tend to have a pronounced position in a number of key industries. As noted by the latest World Investment Report, 2000, newcomers to the list of top 50 transnational corporations from developing economies, continue to be dominant producers in food and beverage; electric utilities or services; and iron and steel industries.

Their mode of entry into foreign markets is primarily through joint ventures, however, the number of mergers and acquisitions is increasing. This is still a somewhat different pattern of entry from their advanced nation counterparts, which typically prefer wholly owned subsidiaries.

DCMNCs have learned to use technology appropriate to their production capabilities, which allows them to compete with local and foreign firms by occupying a special niche market. The general trend is to learn more sophisticated process and product technology from licensing and from joint ventures relationships with MNCs from developed countries. This technology is often modified and adapted to local market and factor conditions. It should be noted that the modification is generally directed at products, rather than processes and it is typically known in the literature as *downscaling*<sup>7</sup>. This is extremely critical for developing countries, based on the fact that small home and host markets do not allow for economies of scale, which are required to maximize the potential of borrowed technology. It is more appropriate for DCMNCs to engage in economies of scope, which is why international expansion can play a critical role in the firm's growth and development.

### **3.5 Summary**

The internal factors of push and pull economies have a dramatic impact on reverse investment decisions of firms from developing economies. Size of the home market as well as size of the host market tends to be a major consideration in the decision process. Competitive advantage over advanced country firms comes from sectoral leadership in a number of labor-intensive industries. Firm level competencies are essential components in the decision making process for foreign direct investment. These competencies cover a wide-range of activities,

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<sup>7</sup>Downscaling refers to the downscaling of the size of production technology so that a smaller scale of operations can be maintained at the same level of technology.

but they are most notable in the size of the firm, its level of skilled personnel, the amount of international experience that it has acquired and its level of global leadership.

## 4. Chapter Four – Case Studies in Reverse Investment

### 4.1 Introduction

This chapter examines four large developing country firms that have engaged in reverse investment activities. The cases are intended to illustrate the theoretical application of reverse investment with an emphasis on role the producer environment plays in reverse investment and the impact that the reverse investment has on the firm's profitability. The selection of the case studies is not random in nature. The sample companies were selected from UNCTAD's list of the top 50 firms from developing countries that appear at least one time on the list during the 1993-2000 reporting period. One hundred and six companies meet this criterion (*see appendix A for a completing listing of firms*). Two of the companies, PDVSA and Cemex, have been included on the list for the entire reporting period. San Miguel Corporation was included on the list at least three times during this period, and Asia Pacific Breweries is a newcomer. This diversity of firms allows us to look at our theoretical framework from a multiple factor perspective. Further, the companies were chosen to be representative of the primary industries in which developing country firms hold substantial market positions, include the following industries: petroleum; construction; food and beverage; and electrical/electronic. Additionally, the companies are representative of different levels of industrial development and internationalization, based on their UNCTAD TNI scores<sup>8</sup>. These cases are reflective of the theory discussed in this dissertation as the cases integrate the

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<sup>8</sup> UNCTAD rates developing country firms based on three composite factors: foreign assets, sales and employment. The averaging of these three factors is used to create their transnational index score, which can be used to determine the degree of internationalization of the firm.

interplay of the three components discussed in chapter one: level of industrial development; country attractiveness (producer environment impact) and theories of FDI and their impact on the firm's reverse investment strategies.

The processes by which these four firms become involved in reverse investment activities are strategically different. Chart 4.1 below provides a brief summation of the factors present in the case studies home producer environment that "pushed" the firms to more receptive producer environments in both the upstream (developed) and downstream (developing) country markets. A brief section at the end of the chapter will discuss the conclusion that can be drawn from the case studies.

#### 4.1 Factors Pushing DCMNCs From the Home Producer Environment

Case Studies	Economic Conditions	Social/Cultural Conditions	Political Conditions	Legal/Regulatory Factors	Environmental Factors
<i>Petroleos de Venezuela PDVSA</i>	Annual earnings (2001) represented 75% of the country's fiscal revenues.		Austerity program plunged the economy into a state of political turbulence.	Expiration of oil concessions, contraction of non-oil businesses forced more dependence on the national oil company.	
<i>CEMEX S.A.</i>	Declining sectoral activities in the Mexican construction market. Company survives by investing in dynamic markets.				
<i>Asia Pacific Breweries</i>	Singapore's small, open economy susceptible to external shocks (Asian crisis 1997).	Shift from low skilled labor force to higher skilled labor force. Food & beverage industry is very labor intensive.			Singapore's continuing problem with its water supply is of constant concern for industries.
<i>San Miguel Corporation</i>	Inflation sending prices in this sector, and other sectors upward.		Political instability created a decline in investor confidence.		Typhoons are a constant, major threat to the area.

In general, economic conditions tended to be a major contributing factor in terms of pushing our sample case companies into other geographic locations. Some of these economic factors centered around the size of the market, such as in the case of San Miguel; almost total dependence on the firm for economic stability in the country, as was the case with PDVSA; declining sectoral importance in the Mexican market affected Cemex; and inflationary pressures on the food and beverage industry in the case of Asia Pacific Breweries.

Political instability was a factor in two of the cases. Venezuela, in an attempt to bring economic stability to the country, found itself facing political upheaval in a country that lacked other supporting industries in its economy. Economic deterioration helped to fuel the political instability in the Philippines, along with the corruption that had infiltrated its government systems. The literature on foreign direct investment often cites these two conditions, economic and political instability, as key factors in a multinational corporation's decision avoid making an investment in a country where these conditions exist.

Our sample companies were also impacted by other restrictive factors that existed in the external producer environment. Many labor-intensive industries, particularly the food and beverage industry, in which Asia Pacific Brewery is a key player, are dependent upon low-cost labor and other low-cost factors of production in order to be competitive. The Singapore government has been diligent in upgrading the skills and literacy level of its population in an effort to attract more high technology industries into its national borders. Highly skilled workers are often drawn away from low-wage, labor-intensive firms. The

government's program has been extremely successful from a socio-cultural aspect in that Singapore has one of the highest literacy rates in the world.

Environmental factors have been a major driver of firms relocating some of their assets outside of the home country base. Extremely harsh weather conditions in the Philippines, particularly during typhoon season has wreaked havoc on industries that have located there. Agricultural businesses can suffer great losses under these inclement conditions. While natural disasters are plaguing the Philippines, the constraint of natural resources, particularly water, is a constant concern for businesses in Singapore. Natural resources are of a limited supply in most countries and the preservation of these resources is becoming a major political lightning rod for many governments. Multinational corporations have often been accused of reaping huge benefits from the use natural resources and then moving on to the next locale when the resources become depleted.

And finally, legal and regulatory factors can be a major push factor in the external environment. In the early stages of Venezuela's development of its oil industry, it was heavily dependent upon foreign oil companies for technology and skills. Taking its cue from its Middle Eastern neighbors, the Venezuela government carefully monitored and regulated the industry with a series of concessions. The country had become almost totally dependent upon the oil industry and Petroleos de Venezuela in particular, that it neglected the other non-oil generating industries leading to a contraction in these businesses. From a competitive standpoint, PDVSA was forced to seek downstream activities in countries outside of Venezuela, most notably the US to assist in supporting the

national industry. Now that the push factors have been established, it is time to turn our attention those pull factors that countries possess in order to attract developing country multinationals.

#### **4.2 Petroleos de Venezuela, S.A. (PDSA)**

Degree of Industrial Development – the company is a transformation of twelve independently owned and operated US and European companies that were nationalized at the expiration of their concessions into the country's national oil company. In a county heavily dependent upon its energy resources and virtually without other substantial industries to depend upon for economic development, PDVSA needed to embark upon building technological capabilities that would cause it to be a major competitor in the oil industry.

Part of its technological capabilities came from the fact that under the concessionary plan, the former foreign investment companies were required to maintain the company at an innovative level in order to receive repayments of deposits that they were required to make. Additionally, PDVSA was able to market its oil through the major international oil companies (Exxon, Shell and Gulf) therefore guaranteeing the company a stable market. Simultaneously the government of Venezuela began investing billions of bolivares into new technology for oil exploration as well as in increasing the production of steel, petrochemicals, hydroelectric capacity and other industrial activities. These investments were driven by the worldwide dependence on oil as a major energy source and the oil booms of 1973-1974 and 1980.

Country Attractiveness – The world market for oil changed dramatically in a number of significant ways that unfortunately sent oil prices into a steady downward spiral, leaving the Venezuela market grappling with a means for economic recovery. The oil producer market in Venezuela benefited in 1973 along with all other oil markets, when a price hike following the Israel-Arab war was realized. To help boost the oil industry in Venezuela, the government made substantial investments in the industry. These investments proved to heavily drain the economy after the first oil boom in 1973-74. The heavy investment made by the government outstripped the industry's ability to meet new demands with increasing oil revenues. To address the situation, the government opted to borrow money in the foreign markets rather than rely on cutting development plans or taxing its citizen and corporations. Unlike the preceding oil boom, the second oil boom in 1980, the price hike that went into effect precipitated a six year decline in oil prices, forcing even greater expenditures by the government perpetuating, Venezuela's economic and eventually political difficulties, and rendering the producer environment less receptive to the country's major oil producer.

Given that PDVSA retained its foothold in countries where it had fulfilled its market seeking objectives, its focus, in part, due to the financial position created by the Venezuelan government and further dictated by technological improvements in the industry and rising North Sea production of light crude, caused the company to shift to asset seeking objectives. The question was

whether or not to accomplish these objectives in upstream or downstream countries.

Reverse Investment Strategies – Given the market position created by its relationship with concessionaires in the home market, an obvious choice for Venezuela was to explore upstream countries in order to accomplish its asset-seeking objective. The most likely choices were the US and European markets. Government policies in the US, based on the political relationships with Middle East nations, dictated that the country at diversify the source of its oil supply, making it an attractive consideration. There were other external environmental or locational factors that made the US market attractive to PDVSA for asset seeking activities. The geographical proximity of the US to Venezuela, coupled with social and cultural factors, such as having many of the largest oil producing resources located in states, which have a large Hispanic population (Texas, Louisiana and Florida), providing for access to language and cultural similarities with its home market, added to making the US a receptive producer environment for the company.

Venezuela has positioned itself in the US market as one of the top ten suppliers of crude and other oil related products to the US (see the chart below for details on the top ten oil suppliers to the US). For PDVSA, the goal was to transform this supplier position into a competitive marketing advantage. When oil prices took a dip below \$10 a barrel, the company sought to secure long-term outlets for its crude oil by increasing its presence in foreign downstream supplier markets, both in the US and Europe.

PDVSA's first asset seeking, downstream venture, outside of Venezuela took place in West Germany in 1983 when it entered into a joint venture partnership with Veba Oel to supply 155,000 barrels of oil per day. While this venture, proved to be successful, it was a point of concern for the current government that held very nationalist views and arguing that the joint venture would dilute national sovereignty. Its success in this venture, along with its continued emphasis on creating asset-seeking objectives, led it to consider a major expansion in the US downstream market.

#### 4.2 Estimated Crude and Products Imports To the US from Leading Supplier Countries

	June 2002 Imports (Thousand Barrels per day)	% of Total Imports	% of Domestic Product Supplied
Canada	1,880	16.6	9.5
Saudi Arabia	1,598	13.9	8.1
Mexico	1,492	12.9	7.5
<b>Venezuela</b>	<b>1,178</b>	<b>10.2</b>	<b>5.9</b>
Nigeria	717	6.2	3.6
United Kingdom	683	5.9	3.4
Norway	535	4.6	2.7
Angola	459	4.0	2.3
Algeria	305	2.6	1.5
Kuwait	265	2.3	1.3
Other	2,420	21.0	12.2
<b>Total</b>	<b>11,532</b>	<b>100.0</b>	<b>58.2</b>
OPEC Countries	4,348	37.7	21.9
Persian Gulf Countries	2,091	18.1	10.6

Source: DOE, Petroleum Supply Monthly, August 2002

PDVSA's asset-seeking investment in the US downstream market came through its purchase of CITGO Petroleum Corporation (Guaregua and Bravo, 2001). CITGO accounts for an 8% market share on gasoline sold in the US, putting the refiner among the top five companies. With this purchase, PDVSA

also owns refineries at Lake Charles, Louisiana and Corpus Christi, Texas. Under PDVSA ownership, CITGO began to flag service stations in Puerto Rico, the first time outside of the US. CITGO's CEO Oswaldo Contreras cited internal CITGO studies that predict, "Hypermarkets may someday have about 15% of the retail market for gasoline in the US. In order to survive, marketers will need to be big, flexible and well-capitalized". Additionally, Contreras noted that, "If marketers are to survive, they need to have location, technology, deep pockets and scale and scope. Many smaller marketers are already to stay in business". To realize the downstream benefits on a broader international scale, PDVSA created CITGO International Latin America (CILA), new subsidiary charged with the task of introducing fuels and lubricants into wholesale and retail marketing operations in the Caribbean, Central and South America.

Around the same time as the CITGO purchase, PDVSA further strengthened its grasp on the US oil market by acquiring 50% of Unocal's downstream assets in the Midwestern United States. This also allowed them to gain access to a deep conversion refinery near Chicago, as well as distribution and marketing facilities in Illinois, Michigan, Iowa, Ohio and Wisconsin.

PDVSA's downstream purchase activities in the US and Europe (*upstream developed country markets*) are simply a springboard for their continued internationalization of the Venezuelan oil industry. Plans are underway for the company to seek similar ventures in the Asian market (*downstream developing country markets*), most notably through relationships with the Indian Government. The question PDVSA will need to address about entering the Asian

market is *how* will it do so? Will it be through market-seeking or asset-seeking activities?

### 4.3 Cemex S.A.

Degree of Industrial Development - Cemex combines a deep knowledge of local markets with its extensive network and information technology systems to provide world-class products and services to its customers. By the end of the 20<sup>th</sup> century, Cemex had amassed an extensive organizational structure. It owned 51 cement plants, had minority equity shares in an additional 17, owned and operated 456 ready mix plants, controlled 175 land distribution centers and had control over 54 marine terminals (www.cementos.com, 2002). See the chart listed below to get a glimpse into Cemex's worldwide operations.

#### 4.3 Cemex Worldwide Operations

As of December 31 <sup>st</sup> 2001	Prod. Capacity millions metric tons/year	Cement Plants owned	Cement Plants minority partnerships	Ready mix plants	Land distribution Centers	Marine terminals
Mexico	27.2	45	3	211	62	8
U.S.	13.2	12	4	87	48	4
Venezuela and Dominican Republic	5.4	4	-	45	26	6
Colombia	4.8	5	-	19	7	-
Central Amer. & the Caribbean	2.5	2	5	6	11	8
Spain	10.4	8	1	79	8	15
Egypt	4.5	1	-	-	1	1
Philippines	5.8	3	-	1	0	2
Indonesia	5.0	-	4	8	12	10
Thailand	0.7	1	-	-	-	-
<b>TOTAL</b>	<b>79.5</b>	<b>51</b>	<b>17</b>	<b>456</b>	<b>175</b>	<b>54</b>

Source: www.cementos.com/gl/gl\_au.asp

Its non-Mexican operations accounted for nearly 60% of assets, just over 50% of revenues and 40% of EBITDA (Ghemawat, 2002). The company had become the third largest company in the world in terms of capacity, as well as the world's largest international trader. It also gained the distinction of becoming the third developing country multinational that was co-listed on UNCTAD's top 50 listing of company's from developing countries and its list of the top 100 companies in the world. The company also achieved special recognition in its industry being one of the few multinationals from a Latin American country to become a model user of information technology, in an otherwise low-tech industry.

Country Attractiveness –The environment plays a key role in a country's attractiveness for the cement and construction industry. Extreme rainfall has a negative effect, since it makes cement based construction more difficult and it increases the possibility of substitute products such as wood and steel being used instead. Demand is also seems to be higher in areas with a warm climate, but demand often lowers in climates of extreme heat or cold. Another favorable environmental factor is countries with long coastal lines, since more se transport means fewer roads, and increased with the share of governmental expenditures in GDP.

Economic factors also play a major role in making countries attractive. Cross country comparisons indicated that the long-run demand for cement was directly related to GDP, with per capita consumption increasing up to the

\$20,000-plus per capita income mark and then declining very gradually (Ghemawat, 2002).

Social factors contribute to a more receptive producer environment as well. Population density is seen as having a positive effect on attractiveness of a country, as it can possibly lead to taller buildings and more complex infrastructure.

Cement companies often owned raw material quarries and located their production facilities close by to cut down on material handling activities. High transportation costs in relation to production costs meant there was only a limited distance in which a plant could deliver product at a competitive price.

Waterborne transportation is more economical than other forms of transportation, in part due to the innovations in seafaring vessels, and the technology used to load and unload the barges. This prompted cement producers to build larger plants that shipped cement to distribution terminals in distant markets as well as serving local ones. Cemex controls a number of distribution terminals around the world.

Reverse investment strategies – Cemex's transformation into a multinational cement producer began in the mid-1980s around the time of the signing of the GATT agreement. The overall strategy of the major competitors in the cement industry was to first develop their national markets, maintaining substantial control in home market, and then to branch out into foreign locations.

Cemex followed this pattern and solidified its position in the Mexican market. Global diversification then becomes central to Cemex's reverse investment strategy. Since 1996 it has continued its global geographic

diversification, entering markets whose economic cycles largely operate independently and which offer long-term growth. Its vision was to successfully compete in an ever-increasing open marketplace. Its initial target markets included Spain, Venezuela, Panama, the Dominican Republic and even the United States, areas where the language and culture are very similar. Penetration into the US market was along the US-Mexico border, where there is a mix of Hispanic and US natives, and most importantly where dynamic markets for Cemex's products exist. Cemex's market strategy was primarily asset seeking, in that it sought to engage in acquisitions of cement companies in these countries, which is the core business of Cemex's operations.

While the Asian market was extremely attractive, it was also one of the more expensive to penetrate. Movement into Southeast Asian became more feasible after the Asian financial crisis in 1997. Cemex's first investments were in the Philippines with equity stakes in Filipino cement producers Rizal and APO. The advantage of aligning with these two producers was centered on their close proximity to ports, which provided export as well as domestic potential. Indonesia was the second Asian market that Cemex targeted. The Indonesia market was considered a prime choice because the political and economic environment in Indonesia had remained fluid for a substantial period. Even in times of political turmoil, the Indonesian market still remains viable primarily because of its dense population; estimated to be around 220 million, almost triple that of the Philippines.

The Middle East has also become a major consideration in Cemex's reverse strategy. Cemex acquired a major stake in Assiut Cement Company, the largest cement producer in Egypt, with about 4 million tons of capacity. This move was precipitated by the Egyptian government's interest in increasing domestic production of cement to help meet the demand that had been growing at an average annual rate of about 11%. With this potential demand available, Assiut was still only able to capture a minimal 17% share of its domestic market. Cemex has announced plans to expand Assiut's capacity to 5 million tons.

China and India pose future opportunities for Cemex, largely because of the populations that exist in these two markets. Each however has enormous challenges to overcome. In India, the two largest international competitors already hold a major stake in the market. For China, approximately 75% of Chinese production was done in small, technologically obsolete plants owned by the local authorities and not run on a commercial basis. Latin America, particularly Brazil seems attractive, however costs are currently prohibitive for entering this market. On the other hand Portugal seems to be a likely target, as well as the entry into African nations.

#### **4.4 Asia Pacific Breweries**

Degree of Industrial Development – the company's development originated from the offshoot ventures of two powerful multinationals, Fraser and Neave Ltd (Singapore) and Heineken NV of Holland (Netherlands). The company benefited in its local market expertise from Fraser and Neave, while it

gained technological and innovative product and brand marketing from Heineken. The consolidation of core competencies from these two established companies in the brewing industry made Asia Pacific Breweries a powerful player in the fast growing beverage market in Asia. APB was able to maximize these strengths through an aggressive expansion plan throughout Asia, where it owns and operates 14 breweries in the Asia-Pacific region. APB is a holding company, which provides management and administrative services to its subsidiaries and joint venture companies, freeing them to concentrate on high quality production. APB's ties to major multinationals from both developed and developing economies has provided it with an extensive distribution network for its products.

#### 4.4 International Distribution Network

*Australia, Bangladesh, Bhutan, Brunei, Canada, Denmark, Diego Garcia, E. Malaysia, East Timor, Finland, France, Hong Kong, India, Indonesia, Ireland, Japan, Labuan, Laos, Malta, Maldives, Mongolia, Nepal, New Zealand, N. Korea, S. Korea, Nigeria, Oman, Philippines, Poland, Qatar, Sri Lanka, South Africa, Switzerland, Taiwan, Thailand, UK, UAE, USA.*

Source: APB's Annual Report 2001

Country Attractiveness – As this is a highly labor intensive industry, the major target market focus has been on those Asian countries which still have a relatively low skill, highly populated work force. The concentration has been on countries with low foreign competitor penetration that provides it with a great deal of market control, and where it can maximize its marketing and advertising campaigns due to language and cultural similarities.

Reverse Investment Strategies – APB's long-range reverse strategy has been to concentrate on expanding into regional markets, employing market-seeking strategies and sustaining brand building, which proved to persist event

through both the good and the difficult years of the Asian economic crisis. Entry into several of the Asian markets consisted of divesting non-brewery operations (both alcoholic and non-alcoholic) and concentrating on core competencies and major brands. APB's market seeking strategies have caused it to focus on a select number of countries in the Asian region. Traditional competitive markets including Singapore, Malaysia, New Zealand and Papua New Guinea continue to maintain and strengthen market performance despite a weakening of the currency in Papua New Guinea.

Indochina (Vietnam, Laos and Cambodia) and Thailand have truly turned out to be the prize regional areas for expansion. In Cambodia, APB dominates the market in terms of both volume and brand presence, while in Vietnam the focus has been primarily on solid volume growth, where the company experienced a 10.9% increase in PBIT, and brewing capacity more than doubled in Thailand (APB Annual Report, 2001).

China remains an important strategic market, based in part on the fact that it is seen as the world's biggest beer market and its having recently gained entry into the World Trade Organization (WTO). APB continues to make investments in both Shanghai and Hainan, despite having incurred significant losses in the market. The firm was able to reduce losses to \$7.9 million, reflecting a 65% reduction over the previous years losses.

#### **4.5 San Miguel Corporation**

Level of Industrial Development – Best known for its internationally distributed beer, San Miguel Corporation is the Southeast Asia's oldest and largest brewer and is the largest publicly listed food, beverage and packaging company in the Philippines. The firm hosts over 100 facilities in the Philippines, Southeast Asia, China and Australia, giving it virtual monopolistic status in its markets. While many companies in the developed world had abandoned conglomerate strategies, San Miguel has thrived in this area, dominating its domestic market with this strategy through the 1980's. This was followed by an era of facilities modernization, with a keen focus on technology infusion into all areas of the business. With the domestic market now firmly under control, San Miguel began a process of decentralization that created a holding company structure, allowing its 18 non-beer operations to be positioned as subsidiaries, and setting the stage for its international expansion into the 1990s. Key to San Miguel's success in the markets that it has entered has been in its partnership relationships. Its management bench was not strong in international experience and it was afraid of diverting too much of its attention directly to international operations for fear of losing its grip on the domestic market (Austin and Roman, 1995).

Country Attractiveness – The conglomerate nature of San Miguel's business structure, coupled with its internationally renowned products, allows it to consider a variety of geographical locations in conjunction with its core competencies. The strength of San Miguel, however, is in its beverage products.

2001 revenues were segmented as follows: beverage (61%), food (27%), packaging (12%) and other business areas (1%). As was noted with Asia Pacific Breweries, countries with low wage costs and a high proportion of unskilled labor are prime target markets for this competitive industry. Countries with similar languages and cultures are key in the success of their regionalization efforts. Countries with free trade or export zones are essential attractors as San Miguel uses them to establish a presence in the market. But most importantly, countries with high growth potential and limited competition in the beer industry are key.

Reverse Investment Strategies – The Company has embarked upon two separate strategies for international expansion. In the Asian region, the strategy quite simply is asset seeking. The major target markets for its regional expansion have been the larger countries of Hong Kong, China, Indonesia, Vietnam, Taiwan and Guam. The company, for expansion purposes, has not earmarked smaller Asian markets or those currently involved in heavy competition. San Miguel's decision to look at the larger markets was based on it's the fact it had an established track record and image for quality in the region, coupled with the fact that the markets it was entering were similar to the Philippine beer market.

While the South China market had become an attractive market for San Miguel and other brewers, two factors contributed to a decision in the early 1990s to avoid direct entry into China, initially. The major reason cited was due to political uprisings following the Tienanmen Square incident to a lesser extent, language was a concern for setting up operations in China, as the company felt it would be difficult to find the right partners in the region. The company ultimately

decided to service the China market from its Hong Kong operations instead (Austin and Roman, 1995). San Miguel eventually reversed this decision, primarily after talks of China entering the WTO, and enter China via Guangzhou. The close proximity of this location to its Hong Kong brewery, its faith in its Hong Kong management team, and its strong brand presence made the decision more palatable.

An expanded export strategy was used to enter these markets and once brand presence was established, the company then invested in creating production facilities independently on its own, or sometimes in concert with indigenous joint venture partners. Its foray into the developed markets, particularly into the United States, Australia and the Middle East, has followed a similar pattern.

Before proceeding to discuss the case results, a summary chart highlighting some of the key pull factors for these cases to both developed and developing markets are provided and discussed.

Ironically, factors which may be perceived as being restrictive in the DCMNCs home country markets, may become some of the same factors which may cause host country markets to be receptive. Even though there were unfavorable economic conditions in San Miguel's home market in the Philippines, the company found countries such as Vietnam and other Indochina nations, which also had less than desirable economic conditions, to be receptive environments for investment. It can only be summarized that the decision was attributed to the presence of other stronger pull factors.

Socio-cultural similarities were key pull factors for Cemex going into Spain and San Miguel going into other Southeast Asian countries. PDVSA was able to capitalize on these factors in other Latin American countries, however, when considering the US market, market size and the US government's desire to diversify its oil sources were stronger pull factors.

The firm's stage of industrial development provides it with certain benefits that dictate its ability to enter other global markets. Petroleos de Venezuela and Cemex S.A., who have attained a level of industrial development that mirrors MNCs from the developed economies have been able to imitate their counterpart's entry into these markets due to their size and level of development.

#### 4.5 Attributes Pulling Case Companies to Developed and Developing Economies

Case Samples	Firm Competencies	Strategic Objectives	Producer Environments (Developed)	Producer Environments (Developing)
<i>Petroleo de Venezuela</i>	Extremely large size, second DCMNC to be cross-listed on the top 100 companies in the world. Leader in an industrial sector that has seen much consolidation by the competitors.	Ensure stable demand for the country's crude oil. Downstream opportunities would accomplish this goal. Accomplished through the acquisition of Citgo.	(Europe) Refineries in peril of closing create a market for heavy crude. (US) Large market potential, looking for diversified suppliers in the oil industry.	Market control through brand awareness and distribution linkages.
<i>Asia Pacific Breweries</i>	Creation of brand awareness	Move into the Asia-Pacific region where there is little foreign competition, basically regional competition.		Third tier industrializing Asian nation (Indochina) where it has socio-cultural similarities and where labor costs are low, brand awareness is high, and the company can control the distribution network. Policies on FDI are extremely positive, particularly with firms within the ASEAN region.
<i>Cemex S.A.</i>	Tonnage capacity (2000-over 65 million tons). Marine terminal control (waterborne transportation is more economical).	Seek dynamic markets where demand for housing, roads, etc is greatest. Operate in multiple regions with different business cycles.	(US) NAFTA connection thought to be beneficial, however, countervailing duty on cement offsets some of this. (Spain) cultural similarity linkages, major distribution terminals and access to the rest of the European market.	(Latin America) particularly in Venezuela, economic conditions, and a depressed cement industry provided opportunities to consolidate their industry. Similar opportunities in Columbia and Chile. (Asia) The Philippines which was once a Spanish colony provided some other social-cultural linkages, they also were experiencing economic woes which created opportunities for low-cost expansion. Indonesian market had long-run potential.
<i>San Miguel Corporation</i>	Flagship product is among the world's largest selling beers; one of the three top selling brands in Asia, and it holds a 90% market share in its home market. In the food market owns cattle and dairy farms, slaughterhouses and processing plants.	Control of the supply chain in both the food and beverage market. Strategic alliances with distributors (Coca Cola), suppliers of metal and plastic packaging (Ball Corporation and Nihon Yamamura Glass Co), for the distribution of its products on a regional and global basis.		It markets products directed at the Asian market and can draw upon the similarity factors in the region. It also takes advantage of the low cost labor in the southeast Asia area, where economic conditions have not been as stable over the past several years.

## 4.6 Analysis and Results

The case results will be analyzed in terms of the current, albeit limited research available in reverse investment activities. Makino, Lau and Yeh (2002) developed a conceptual model to address a firm's motivations to enter developing country verses less developing country markets.

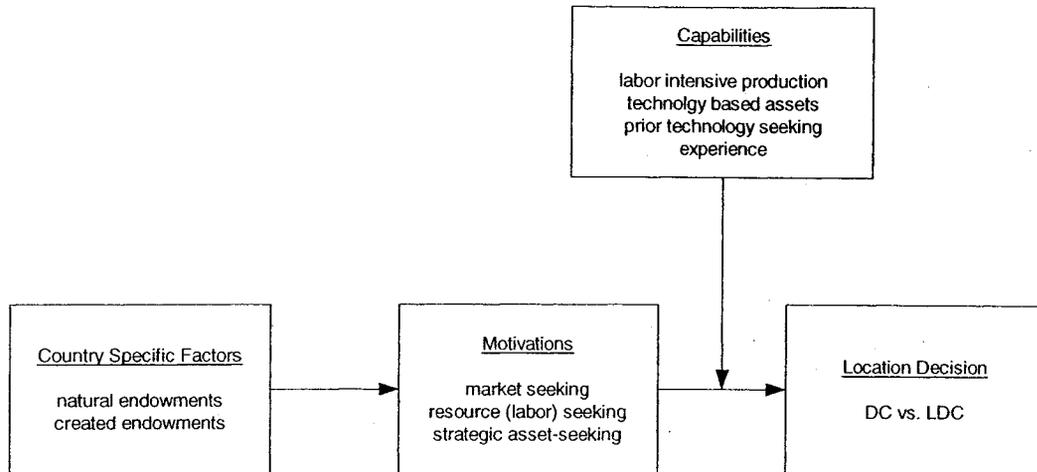


Figure 4.1

The model suggests that the NIE decision to locate in a particular producer environment is simply based upon the firm's capabilities that support the investments. It however does not address the country specific factors that exist in the new environment, of which risk is a key component. These risk factors will be accountable for whether the firm ultimately makes the decision to enter the market regardless of the risk, delays the investment or abandons the investment altogether. The prior research makes several determinations on how NIE firms' motivations and capabilities influence their actual FDI decisions regarding the choice of FDI location. In turn the case studies will be reviewed under this

criteria to see if they follow along the same patterns or if there are intervening factors that would cause an altered course of action.

The first motivation to be considered is that of strategic asset seeking.

Three hypothesis were set in Makino et al, regarding this type of motivation:

- (a) NIE firms are more likely to invest in DC (upstream) than in LDC (downstream) when their primary motivation of investment is to seek technology based assets in a host country.
- (b) NIEs will invest in upstream when they possess more superior technological assets than indigenous competitors in a host country.
- (c) NIEs are more likely to invest upstream when they have prior experience of seeking assets from foreign firms.

Two of our case samples, PDVSA and Cemex would fall into the category of making strategic asset seeking investments in upstream country markets. First, let's examine the activities of PDVSA. In regards to the first consideration, PDVSA's primary motivation in the US market was not to seek technology-based assets. In fact, it was seeking a downstream supplier market, to assist in its strategy for securing the sale of Venezuelan crude in foreign markets. To say that PDVSA's technological assets were more superior than the indigenous competitors would be clearly untrue. PDVSA gained its technological capabilities from investments in technology by upstream firms that held concessions in the Venezuela oil industry. Therefore the first two premises do not hold for the first case sample. The third, however, for the reason previously stated does ring true. However the method used to accumulate the experience, the

nationalization of foreign assets and the holding of key assets to ensure the transfer of technology, may be questionable, it still in effect satisfies the fact that they have gained experience in seeking assets from foreign firms. PDVSA's asset seeking activities into the European market, through its joint venture with Veba Oel were very similar to the experience in the United States.

The contributing factors that detract from the hypothesis forwarded by Makino et al, is that the producer environments for the major competitors in their home markets had become unattractive for them, while at the same time becoming attractive for PDVSA. Economic and political shifts in the oil market had dramatic impacts on the competitors, their environments and the ability to maximize profits while trying to find ways to reduce risk factors. To a great extent, PDVSA's ability to leverage at least similar capabilities as its competitors in the upstream market were proven to be a successful motivation for their entry into this receptive producer environment.

The attention is now directed at the second case study, Cemex. The primary motivation of Cemex was market seeking, rather than technology activities. In actuality, Cemex is considered more technologically advance than some of the upstream firms, noting that it is the third largest construction company, in terms of assets, in the world. The primary motivation for Cemex is finding dynamic markets that fall in line with positive environmental factors that contribute to increasing profits, while at the same time reducing risks. Cemex has engaged in the acquisition of assets and experience from other countries. In the construction business, indigenous competitors have been exemplary in protecting

domestic markets. This is partly due to the geographic dispersion of the major competitor and largely to the high transportation costs associated with doing business in certain geographic locations.

In light of the analysis of these two case studies, substantial support of the hypothesis is not clearly evident and other supporting factors are present which suggest that other factors have a more substantial impact on the investment decision.

Makino et al also render hypotheses in regards to resource (labor) seeking motivations, which shall now be explored. The research specifies that:

- (a) NIEs are more likely to invest in LDCs (downstream) when their primary motivation is to gain access to low cost labor in a host country.
- (b) NIEs will invest downstream when they possess more superior labor-intensive production capabilities than indigenous competitors.

Three of our case studies have firms that made investment for low-cost labor reasons. For Asia Pacific Breweries and San Miguel Corporation, the industrial sector that these firms operate in dictate that they seek low cost labor to remain competitive in the market. However, there were stronger motivations for directing their investments in downstream markets than in upstream ones. Socio-cultural factors tended to weigh much more heavily in the decisions of these firms. There are growing niche markets in which competitors in this industry can compete. Foreign nationals have not made heavy investments in this market

because they are not looking for low cost labor; they have not done so because of the cultural boundaries that must be overcome. Asian firms hold language and cultural similarities that cannot be easily maximized in upstream markets. Even though China is considered the second largest market for the beer industry in Asia, which has an abundance of low cost labor, it was political reasons that originally kept San Miguel from entering the market. Foreign firms entering this market do so through joint ventures or strategic alliances, because they rely on the local company knowledge of the market. Brand awareness is essential to be successful here.

The construction industry is also a labor-intensive industry, however, dynamic markets with complementary environmental factors drive the investment decision more so than low cost labor. Cemex has used technology to reduce costs in other ways so that low cost labor factors, while important, are not the primary driver of international investment into these market areas.

The final area of motivation to be considered is market-seeking activities.

Here, Makino et al provides these hypothesis:

- (a) NIE invest in upstream countries when their primary purpose of investment is to explore market opportunities. This statement also suggested that, ceteris paribus, NIEs tend to invest in high income countries to produce differentiated goods to high income customers and downstream to produce labor intensive goods to low income customers.

- (b) NIEs invest in upstream when they possess more superior capabilities than the indigenous competitors.
- (c) NIEs invest downstream when they possess superior labor-intensive capabilities than the indigenous competitors.

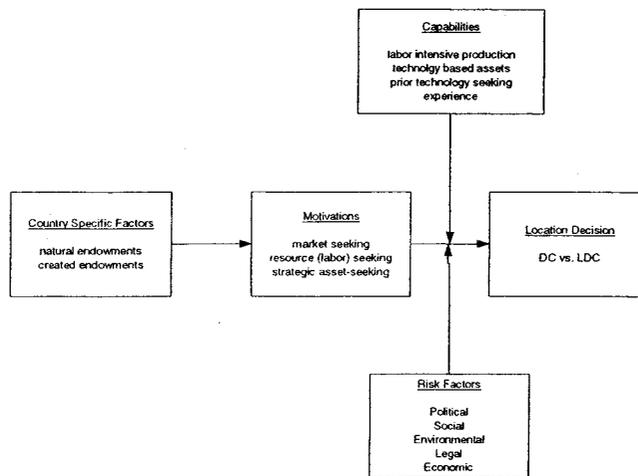
First, let us look at PDVSA, which in fact invested upstream for market seeking purposes. The motivation as was previously stated was to sell higher income products, but to gain control of the supply chain in an upstream market. It has already been noted that PDVSA's technical capabilities are at best equal to the indigenous competitors, however, the economic conditions in their country dictated that they needed to find a source to distribute their product and to begin to create brand awareness in the higher income markets.

In regards to the final point, each of the case studies showed support of this factor in that these large developing country firms had accrued superior labor-intensive capabilities and intended to maximize them in the downstream country markets.

#### **4.7 Summations and Conclusion**

In comparing the case studies to prior current research in the area of reverse investments there is support of the theoretical framework that producer environments do contribute significantly to the international investment decisions of large firms from developing countries. To date this has not been a focus of attention for this market segment. We do know, however, from research on MNCs that the investment decision encompasses both risk and return activities.

Producer environments provide the greatest opportunity to investigate the risk factors that affect the investment decision of not only DCMNCs, but MNCs as well. This goes back to the issue raised in Kwok and Reeb (2000) that risk classes among countries, and quite possibly industries, may need to be factored into any empirical investigation of this topic. To Makino et al's original conceptual model I would add a factor to assess risk.



**Figure 4.2**

However this assessment of risk must somehow become interrelated to the firm's motivations and capabilities, not simply as a stand-alone factor for empirical testing. The method to best address this may be through an international investment decision model that weighs particular risk factors for a firm based upon their unique capabilities and motivations.

## **5. Chapter Five - Implications**

### **5.1 Introduction**

The previous chapters have presented theoretical and empirical arguments to further support the investigation of existence of restrictive and receptive producer environments on reverse investment decisions by developing country multinationals. This is supported by the evidence that shows restrictive factors in the producer environment pose certain risks to the firm in addressing market, resource or technology motivated activities. Chapter three presented a theoretical argument, which suggested that a reverse investment strategy might be viable for firms facing restrictive factors in their home producer environments that collide with their core competencies and strategic objectives, ultimately pushing them to seek more attractive or receptive producer environments in other geographical locales. The chapter went on to distinguish between pull factors, which exist in both developed and developing producer environments that would be attractive to firms looking to locate in these host country environments. Distinguishing between developed and developing economies allowed for contrasting of benefits that firms from developing countries might gain depending upon the direction of their investments. Firm size, the industrial sector it represents and the levels of industrial development are all key factors in deciding upon the direction the investments. Chapter four described in detail four cases studies of the use of reverse investment strategies by large developing country firms. The purpose of these case studies was to show that reverse investment is a strategy that firms can and do use in international competition and for gaining or sustaining a

competitive advantage. The case studies were also used to highlight the theoretical application of "restrictive" and "receptive" producer environments and the impact these concepts have on reverse investment decisions made by developing country firms. The strong evidence of the importance of restrictive and receptive producer environments on reverse investment activities for developing country firms presented in this dissertation has implications on three distinct levels: for managers, for public policy and for future research.

## **5.2 Managerial Implications**

For managers, the new understanding gained of the impact of restrictive and receptive producer environments on reverse investment will encourage and assist them in considering key risk factors that affect their global business investment strategies. They will hopefully led to the development of better investment decision models. As the Petroleos de Venezuela, Asia Pacific Brewery, Cemex and San Miguel example cases illustrate, managers are already using reverse investment successfully. However, in each of these cases it is likely that had the firms fully understood the issue of restrictive and receptive producer environments while considering strategic options, they would have chosen to pursue reverse investment strategies earlier or more aggressively than what actually occurred. Each of the case samples are of companies that have long and substantial histories within their respective industrial sector, some dating back to the 1800s. However, the concept of reverse investment is a relatively recent strategic option employed by the many of the firms studied in this dissertation. In

the PDVSA case, due to the negative reaction from political factions in the Venezuela government to investments made in Germany, which they believed ran counter to their nationalistic views, the company almost passed over the opportunity to embark on the PDVSA/Citgo deal. To illustrate the sensitivity of the topic of reverse investment in the company, company officials working on the deal did so in an undercover mode until they could sort out the political concerns of key government officials (Lopez-Mendoza and Nanda, 1999). In the case of Cemex S.A., the company began to embark on reverse investment strategies only when under attack of competitors coming into the Mexican territory or into countries, which were in the general geographic location of Cemex. Their foray into reverse investment activities was more reactive than proactive to the use of this strategic option.

These examples suggest that a better understanding of the producer environments may allow managers to become more aggressive in considering reverse investment, rather than waiting to take reactionary measures, whether threaten by outside competition or deterioration of political or economic conditions within the home country environment, such as what took place in the Philippines and in Singapore which forced both San Miguel and Asia Pacific Breweries to seek investments outside of the home country producer environment.

Also in chapter three it was noted that the firm's competencies are an essential element in reverse investment decisions. Growth and success of the company has an impact on growing the industrial sector in the producer environments, in which it operates. In chapter four these firm competencies were

linked with the strategic objectives of the firms and the producer environments in which the ultimately made a decision to make an international investment. The implications for managers has been shown to be of great importance, now the attention of reverse investment strategies for DCMNCs is focused on implications in the area of public policy.

### **5.3 Public Policy Implications**

The recognition of producer environment roles in reverse investment strategies for developing country firms has important implications for public policy consideration. Countries, i.e. the government, have a great deal of influence on factors that affect the producer environment. Many nations have established foreign direct investment policies that dictate the level and type of foreign investment that enters their home borders. These policies usually focus mainly on the issue of how the behavior and performance of foreign controlled firms differ from those of domestically controlled firms. Central among the debates that governments must wrestle with is how to balance the needs of growing domestic firms, with enticing foreign firms that can bring jobs, technology and stability to the host country's economic base. However in reality the fear of some members of government is that foreign controlled firms import more of their inputs than domestically controlled firms, that they take such actions as reducing employment in the host nation more readily than locally owned firms and that they place less emphasis on developing and applying new technologies I the host nation than do locally owned firms. At odds is whether or not the foreign

subsidiary is reduced to simply maximizing the profits it generates in the host nation to the competitive advantage of its parent organization. On the surface, this is a general speculation of the internalization theory. In many instances, the foreign subsidiary is not free to establish its own competitive advantage outside of the parent's competitive advantages, where it might be able to utilize the resources of the host country in a manner that benefits both parties. For this reason, many nations have instituted as part of the foreign investment policies a limitation on ownership in some or all of their industry, and have restricted ownership in other areas or key industries. The difficulty with this line of thinking is that the more the policies of a nation are seen to be restrictive, the greater the possibility that firms will locate elsewhere, where producer environments are more receptive than restrictive.

Nations have begun to realize that they are in high competition with other nations in attracting foreign investment into their countries. For years, many nations have provided firms with tax holidays and other incentives in an effort to make their environments more receptive. The difficulty for a country's government is in determining how their policies and resources can be broad enough to attract firms from different industrial and service sectors. As witnessed in the case of Asia Pacific Brewery, the labor skill set that it needed for its industry was in conflict with the overall policy direction for the labor skill set in Singapore determined by the Singaporean government. The return on investment to host country's for creating receptive producer environment comes in the form of rent extraction or revenue generation from corporate taxes. A growing

emphasis is being placed on the creation of "clusters" within nations. Clusters often referred to as industry or regional agglomerations of firms are a special segment of cooperative business structures that allow corporations in both the domestic and international markets to address the issue of competitive advantage while establishing a framework of mutual cooperation with a select group of public and private institutions. This is becoming a major strategic tool that governments can utilize to create positive, receptive producer environments within the country.

Government's are recognizing that reverse investment strategies are a definite boost to their economic development program. Research for this dissertation, while teaching at Xavier University, led to information from the Louisiana Economic Development (LED) commission, which was embarking on a bold new industry-based cluster approach for growing the state's economy. The commission was in the process of hiring an International Services Director to address two key responsibilities:

- Develop strategies in concert with LED's cluster directors to enhance cluster activities on the international level, and
- Enhance cluster development by assisting cluster directors in identifying export and reverse investment opportunities for the cluster companies.

So government's at all levels are putting emphasis on the issue of reverse investment as a key economic development strategy. The final implication to be discussed in this thesis is the implications for further research.

#### **5.4 Implications for further research**

There are several implications of this research for the additional development of our knowledge and understanding of multinational corporations for developing countries. The most basic contribution of the research is to establish the role of restrictive and receptive producer environments and their link to reverse investment in the international economy.

One benefit of understanding the impacts of restrictive and receptive producer environments regarding reverse investment is that it creates an important new decision-making tool for firms to use in determining geographic location selection. Quantitative and qualitative criteria can be created for the five external producer categories: economic conditions, socio-cultural conditions, political conditions, environmental factors, and legal/regulatory factors. Firms can then generate requirements or attractors that are needed for successful competitive advantage in a particular environment, then analyze the data to determine a proper fit exists. In some cases, firms might decide to use this information to negotiate with host governments regarding special incentives that might be offered in cases where the full range of attractors are not present in the environment. While a firm may not be apt to change its strategic intent simply to adapt to one particular producer environment, it does provide valuable information to the firm as to whether it has competencies that would be suitable to the type of producer environment that exists for the that the government may be trying to create.

In this regard, further research into how and why governments great their foreign direct investment policies is also beneficial. Government can determine if

they in fact are creating protectionist policies to help boost the home countries industries or if in fact they are trying to create a receptive environment for firms coming to do business in their country. Like the case of Singapore, the government had set a firm direction for the development of its human capital resources based on the types of industries that it felt its physical environment could support. This proactive stance allows governments more coordination of third party resources that are needed in creating the type of producer environment that it desires to attract. This in fact also helps to support the institution of clusters within the producer environment. Government can now set strategies where they go after reverse investments rather than waiting for firms to see them as potential opportunities.

This thesis has set the basic framework for future research, which can be taken in a variety of directions. One direction is to look at segmenting by industrial sector and trying to identify the key attractors and risk factors to a specific industry and then determining where maximum benefit from geographical location might take place. Another way to segment the research is to look regional country grouping to see if particular attractors are being developed on a regional basis in line with regional trade activities or regional development of countries, which appears to have taken place in Asia with the first tier of industrialized countries (*Hong Kong, Korea, Singapore and Taiwan*) and then a second tier developed (*Malaysia, Thailand, Indonesia and the Philippines*) that benefited from investments made by the first level. Some speculate that a third tier (*Indochina*) is quickly developing and that they will be the next Asian

benefactors of reverse investment. Certainly, the case samples provide some evidence that this is taking place in that both Asia Pacific Breweries (*Singapore - 1<sup>st</sup> tier*) and San Miguel (*the Philippines - 2<sup>nd</sup> tier*) are heavily investing in the third tier of Asian countries, primarily with a focus on Vietnam. While not as structurally elaborate as their Asian counterparts, Latin American countries are investing in other Latin American and Caribbean countries as primary reverse investment targets.

This final chapter of the dissertation has outlined some of the important implications of reverse investment, particularly as it relates to restrictive and receptive producer environments. Based on the strong theoretical evidence of reverse investment role in international investment, these implications deserve further consideration, with an emphasis shifting to empirical testing and analysis.

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Table 1.1 Top Transnational Corporations from Developing Economies

Corporation	Country	Industry	N. Africa & M. East	Sub			Asia	North America & Caribbean	Latin Amer	Oceania	Total	
				Saharan Africa	Europe						Locations	Developed
SABIC-Saudi Basic Industries Corp.	Saudia Arabia	Chem/Pharma								0		
Barlow Limited	South Africa	Diversified		3	1					4	0.25	0.75
Plate Glass & Shatterprufe Industries	South Africa	Diversified								0		
South African Breweries	South Africa	Food/Beverages		1	1					2	0.50	0.50
Sappi Limited	South Africa	Paper	1		6	1	1	1	1	11	0.64	0.36
China Harbours Engineering Group	China	Construction								0		
China State Construction	China	Construction								0		
Dong-Ah Construction Industries	China	Construction								0		
China Cereals, Oils, Food Imp & Exp	China	Diversified				1				1	0.00	1.00
China National Chemicals	China	Diversified								0		
China National Metals & Minerals	China	Diversified								0		
China Shougang Group	China	Diversified								0		
Shougang Corporation	China	Diversified								0		
China Iron & Steel Industrial & Trading	China	Metals								0		
China Foreign Trade Trans. Corp.	China	Transportation								0		
New World Development	Hong Kong	Construction				1				1	0.00	1.00
Citic Pacific Ltd	Hong Kong	Diversified				1	2			3	0.67	0.33
Guangdong Investment	Hong Kong	Diversified								0		
Hutchinson Whampoa	Hong Kong	Diversified			1	1				2	0.50	0.50
Wing On International Ltd.	Hong Kong	Diversified			2	7	2	1	1	13	0.31	0.69
First Pacific Company	Hong Kong	Electronics				2			1	3	0.00	1.00
CDL Hotels International Ltd.	Hong Kong	Hotels								0		
Dairy Farm International	Hong Kong	Retailer								0		
Hongkong & Shanghai Hotels	Hong Kong	Tourism								0		
Cathay Pacific Airways	Hong Kong	Transportation				1	2			3	0.67	0.33

Orient Overseas International	Hong Kong	Transportation								0		
Reliance Industries	India	Chem/Pharma								0		
Tata Iron and Steel Co.	India	Metals				1	1			2	0.50	0.50
Tong Yang Cement Mfg. Co. Ltd	Korea	Cement								0		
Hyundai Engineering & Construction	Korea	Construction								0		
Ssangyong Cement Industrial Co. Ltd	Korea	Construction		2		7	2	2	1	14	0.14	0.86
Daewoo Corporation	Korea	Diversified	4	4	16	13	2	8	1	48	0.38	0.63
Hyundai Corporation	Korea	Diversified				1	2			3	0.67	0.33
Sam Yang Co. Ltd	Korea	Diversified								0		
Sunkyong Group	Korea	Diversified				1	1			2	0.50	0.50
LG Electronics	Korea	Electronics	1		5	5	2	2	1	16	0.44	0.56
Samsung Electronics	Korea	Electronics			1	5	1			7	0.29	0.71
Yukong Ltd.	Korea	Petroleum								0		
Hyosung Corporation	Korea	Trading				1	1			2	0.50	0.50
Korea Electric Power	Korea	Utilities			1	4	2		1	8	0.38	0.63
Amsteel Corporation Berhad	Malaysia	Diversified								0		
Sime Darby Berhad	Malaysia	Diversified			1	4			3	8	0.13	0.88
Genting Berhad	Malaysia	Hotels								0		
Petroliam Nasional Berhad	Malaysia	Petroleum				6		1	1	8	0.00	1.00
Malaysian Airline Berhad	Malaysia	Transportation								0		
Malaysian Int'l Shipping Co. Ltd.	Malaysia	Transportation								0		
Ayala Corporation	Philippines	Food/Beverages				1				1	0.00	1.00
San Miguel Corporation	Philippines	Food/Beverages				2				2	0.00	1.00
Keppel Corporation	Singapore	Diversified			3	6	1		1	11	0.36	0.64
Creative Technology Ltd	Singapore	Electronics		1	10	7	2		1	21	0.57	0.43
Fraser & Neave Limited	Singapore	Food/Beverages								0		
Want Want Holdings, Limited	Singapore	Food/Beverages								0		
Singapore Airlines	Singapore	Transportation				1	1			2	0.50	0.50
Singapore Telecommunications Ltd	Singapore	Utilities			1	11	1		2	15	0.13	0.87
Asia Cement Corp.	Taiwan	Cement			1		1	1	1	4	0.50	0.50
Formosa Plastic Group	Taiwan	Chem/Pharma				1	1			2	0.50	0.50

Acer Group	Taiwan	Diversified	1	16	13	2	8	3	43	0.42	0.58
Chinese Petroleum	Taiwan	Diversified			1				1	0.00	1.00
Sampo Corporation	Taiwan	Electronics							0		
Tatung Co.	Taiwan	Electronics		3	4	1		1	9	0.44	0.56
China Steel Corporation	Taiwan	Metals							0		
Evergreen Marine	Taiwan	Transportation							0		
Charoen Pokphand	Thailand	Food/Beverages							0		
Perez Companc S.A.	Argentina	Petroleum					1		1	0.00	1.00
YPF S.A.	Argentina	Petroleum	3	10		1	7	1	22	0.50	0.50
Jardine Matheson Holdings	Bermuda	Diversified		3	11	1	1	3	19	0.21	0.79
Embraer-Emp Bras De Aeronautica S.A.	Brazil	Aerospace							0		
Cia. Hering	Brazil	Diversified							0		
Industries Villares S.A.	Brazil	Diversified							0		
Souza Cruz S.A.	Brazil	Diversified							0		
Ceval Alimentos S.A.	Brazil	Food/Beverages							0		
Companhia Cervejaria Brahma	Brazil	Food/Beverages							0		
Sadia Concordia S. A.	Brazil	Food/Beverages					1		1	0.00	1.00
Aracruz Celulose S.A.	Brazil	Paper		1		1	2		4	0.50	0.50
Petroleo Brasileiro S.A. Petrobras	Brazil	Petroleum	1	1	1	1	4		8	0.25	0.75
Usiminas-Usinas Siderurgicas de Minas GE	Brazil	Steel							0		
Companhia Vale do Rio Doce	Brazil	Transportation					1		1	0.00	1.00
Cia de Acero del Pacifico de Inversiones	Chile	Diversified							0		
Compania de Petroleos de Chile	Chile	Diversified							0		
Enersis S.A.	Chile	Electrical Svcs					5		5	0.00	1.00
Gener S.A.	Chile	Electrical Svcs							0		
Compania Mfg's de Papeles y Cartones	Chile	Paper							0		
Empresas CMPC S.A.	Chile	Pulp/paper							0		
Compania de Telecomunicaciones	Chile	Utilities							0		
Bavaria S. A.	Columbia	Beverages					1		1	0.00	1.00
Panamerican Beverages	Mexico	Beverages				1	1		2	0.50	0.50
Grupo Celanese S.A.	Mexico	Chem/Pharma		1		2	1		4	0.75	0.25

Cemex S.A.	Mexico	Construction	2	1	1	3	7	0.43	0.57	
Empresas Ica Sociedad Controladora S.A.	Mexico	Construction	2		1	8	11	0.27	0.73	
Desc S.A. de S.V.	Mexico	Diversified			1	1	2	0.50	0.50	
Gruma S.A. de C. V.	Mexico	Food/Beverages				2	2	0.00	1.00	
Grupo Industrial Bimbo S.A. de C.V.	Mexico	Food/Beverages		3			3	0.00	1.00	
Grupo Televisa S.A de C.V.	Mexico	Media				1	1	0.00	1.00	
Vitro S. A.	Mexico	Other			1	1	2	0.50	0.50	
Grupo Sidek	Mexico	Tourism				1	1	0.00	1.00	
Petroleos de Venezuela S.A.	Venezuela	Petroleum					0			
			<i>10</i>	<i>13</i>	<i>89</i>	<i>125</i>	<i>42</i>	<i>66</i>	<i>24</i>	<i>369</i>
			<i>0.03</i>	<i>0.04</i>	<i>0.24</i>	<i>0.34</i>	<i>0.11</i>	<i>0.18</i>	<i>0.07</i>	
			<i>Region 1</i>	<i>Region 2</i>	<i>Region 3</i>	<i>Region 4</i>	<i>Region 5</i>	<i>Region 6</i>	<i>Region 7</i>	

*Data Source(s): the Directory of American Companies in Foreign Locations and the International Directory of Public and Private Corporations*

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