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Internationalization of Developing-Country Enterprises through Outward Foreign Direct Investment*

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Executive summary

Outward foreign direct investment (OFDI) from developing countries and economies in transition is increasing. Various country studies commissioned by UNCTAD indicate that developing-country enterprises, including small and medium-sized enterprises (SMEs), are involved in OFDI. However, these enterprises face a number of challenges in investing overseas. These challenges must be addressed if developing-country governments are to use OFDI – a means of enterprise internationalization – to enhance the competitiveness of their enterprises.

Evidence suggests that OFDI can play an important role in enhancing the competitiveness of developing-country enterprises by providing access to strategic assets, technology, skills, natural resources and markets and increasing efficiency. More developing countries are now paying closer attention to OFDI, and are a growing source of FDI for other developing countries, thus strengthening South-South cooperation.

This note surveys current trends in OFDI from developing countries. It examines the drivers, motivations and obstacles of OFDI, its impact on enterprise competitiveness, and policy options. It also raises issues that need to be addressed in order for the phenomenon to be analysed in greater depth so as to identify feasible strategies and policy options for enhancing the competitiveness of enterprises, particularly SMEs, through OFDI. The note draws on analysis of selected case studies.

* This document is being issued on the above date for technical reasons.
Valuable inputs were provided by John Mathews, Macquarie Graduate School of Management, Macquarie University, Sydney, Australia.

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Introduction

1. "Internationalization of enterprises is one of the essential ways for strengthening the competitiveness of developing-country firms", according to a statement by UNCTAD's Commission on Enterprise, Business Facilitation and Development at its ninth meeting (on 22–25 February 2005 in Geneva). The Commission requested UNCTAD to continue its policy analysis of how developing-country firms use internationalization, including linkages, global value chains and outward foreign direct investment (OFDI), to enhance their competitiveness.

2. UNCTAD has produced a series of country studies examining issues and developments related to internationalization of developing-country enterprises through OFDI.[1] In addition, in 2005 it organized two national seminars (in Brazil and China) to discuss how the regulatory framework for OFDI in these countries could be improved to enhance enterprise competitiveness. The seminars brought together policy makers, enterprises and experts from developing (and developed) countries to exchange experiences and best practices.

3. In recent years, an increasing number of developing-country firms have made international news by acquiring well-known global companies. The increase in OFDI from developing-country firms is being accompanied by an increase in the number of transnational corporations (TNCs) from developing countries, as has been documented in various UNCTAD publications.[2] These TNCs, many of which are small despite being international, and many of which expanded through their internationalization efforts (rather than starting out large), are part of a “second wave” of such developing-country TNCs that has emerged since the 1980s, after a “first wave” in the 1960s and 1970s. It is interesting to examine the extent to which such firms have used the interconnected nature of the globalizing economy to increase their internationalization and competitiveness. OFDI also facilitates South-South cooperation, as the bulk of it goes to other developing countries (UNCTAD 2005a).

4. This note should facilitate discussions on whether and how OFDI can enhance enterprise competitiveness, particularly that of SMEs, in developing countries. Analysing enterprise development, competitiveness and policy issues with respect to OFDI, in particular in the context of SMEs, has always been a challenge because of the lack of data and systematically documented cases. Given the statistical limitations, this note draws on anecdotal evidence and the experiences of developing countries' enterprises in internationalization through OFDI. After a brief overview of recent trends in OFDI, the note outlines the main factors contributing to these trends, particularly in the context of enterprise development, including government policies and enterprise strategies. It discusses how OFDI can enhance enterprise competitiveness and whether it is different for large companies as opposed to SMEs. It also raises questions regarding the impact of OFDI on the competitiveness of developing-country firms with a view to identifying strategies and policy options that could contribute to enhancing the benefits of OFDI for enterprise development, particularly that of SMEs.

Recent trends in OFDI from developing countries

5. OFDI from developing economies and countries in transition has increased rapidly in recent years, from $147 billion in 1990 to over $1 trillion in 2004 (see figure 1 and table 1). These

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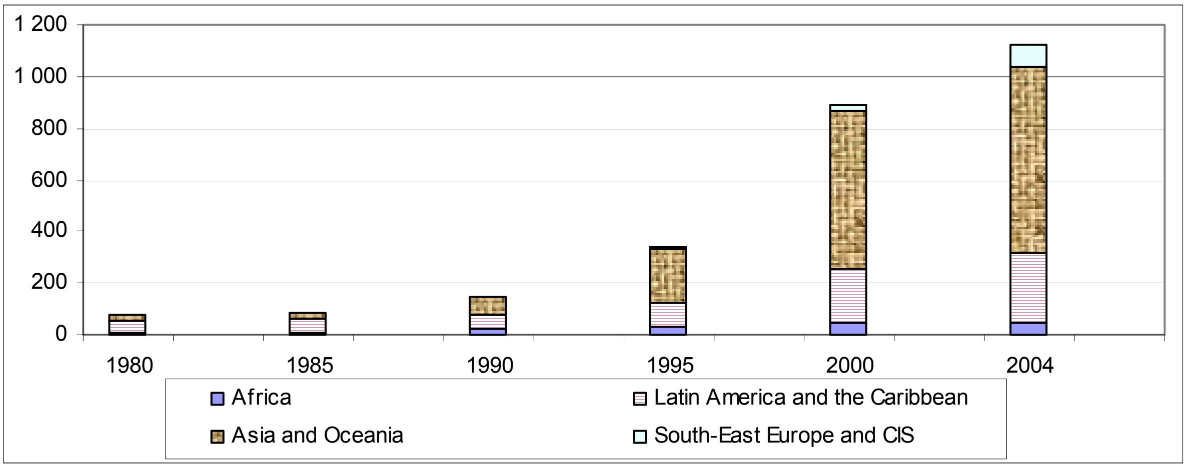
[1] Including Argentina (TD/B/COM.3/EM.26/2/Add1), India (TD/B/COM.3/EM.26/2/Add2), the Russian Federation (TD/B/COM.3/EM.26/2/Add4), Singapore (TD/B/COM.3/EM.26/2/Add3) and South Africa (TD/B/COM.3/EM.26/2/Add5), as well as case studies on Chile, China, Egypt, Malaysia, the Republic of Korea, Slovenia, Thailand and Turkey.

[2] See UNCTAD 2003, UNCTAD 2004a, UNCTAD 2004b and UNCTAD 2005.

economies together accounted for 11 per cent of the world's OFDI stock in 2004, compared with 7 per cent in 1990. OFDI flows as a percentage of gross fixed capital formation (GFCF) are considerably higher than the world average for such economies as Hong Kong (China), Taiwan Province of China, the Russian Federation and Singapore. As a result of OFDI, more enterprises from developing countries are transnationalizing. For instance, the number of developing-country firms among the Fortune 500 rose from 29 in 1998 to 45 in 2005.

Figure 1. Developing economies: OFDI stock by region, 1980–2004
(billions of dollars)



Source: UNCTAD 2005b, *World Investment Report, 2005*.

6. The economic literature identifies two waves of OFDI: in the 1960s–1970s and thereafter. The first-wave firms were driven mainly by efficiency and market-seeking factors (identified in literature as push factors[3]); were mainly directed towards other developing countries, most often neighbouring countries; and were dominated by firms from Asia (India, the Republic of Korea, Hong Kong – China, Malaysia, Singapore) and Latin America (Argentina, Brazil, Mexico). The second wave was more strategic-asset-seeking and driven by a combination of pull and push factors (with pull factors dominating); was directed more towards developed countries and developing countries outside the region; and was led by firms from Hong Kong (China), Taiwan Province of China, Singapore and the Republic of Korea (Dunning et al. 1996). It has also been noted that countries such as Argentina, Brazil, India and Mexico saw their OFDI take off during the 1990s after stagnation in the 1980s.

7. Not all developing regions have participated equally in the emergence of international investment flows. The internationalization of business firms from developing countries is furthest along in East Asia, followed by Latin America. OFDI from the BRIC countries – Brazil, Russia, India and China – is now growing rapidly and looks set to dominate OFDI activity from developing countries in the future (Sauvant 2005). Other established investors such as Singapore and emerging ones such as Malaysia, South Africa and Turkey are expected to add to this OFDI growth. Following is a discussion of the main OFDI trends and players.

[3] "Push" factors relate to economic environments in the home country as well as corporate strategies that encourage firms to go abroad. They include saturated home markets, currency appreciation, cost disadvantages, limited land, limited labour supply, and the need to follow competitors and suppliers. "Pull" factors relate to location-specific advantages of the host countries such as market potential, low-cost labour, incentives, investment opportunities, technology and skills.

Table 1. OFDI from selected regions and developing economies, 1990-2004
(billions of dollars)

Region/economy	OFDI stock 1990	OFDI stock 2003	OFDI stock 2004	Change in OFDI Stock (i.e. flow in 2003-2004)	OFDI flow as % of GFCF* 2002-2004	Selected enterprises (TNCs)
World	**1,785**	**8,731**	**9,732**	**1,001**	**8.9**	
Developing economies and territories	**147**	**927**	**1,036**	**109**	**2.9**	
Africa	**20**	**43**	**46**	**3**	**1.2**	
South Africa	15	27	29	2	1.5	TMN, AngloGold Ashanti, Illovo Sugar, Mondi, Steinhoff
Latin America and the Caribbean	**59**	**261**	**272**	**11**	**3.2**	
Argentina	6	22	22		0.0	Tenaris Siderca
Brazil	41	55	64	9	3.7	Odebrecht Engineering, Construction Embraer
Cayman & Virgin Is. (UK)	2	118	116	-2	0.0	
Chile		14	14		6.5	
Mexico	1	14	16	2	1.3	Cemex, Telmex, America Movil, FEMSA, Grupo Alfa
Asia and Oceania	**68**	**623**	**718**	**95**	**2.9**	
West Asia	**8**	**15**	**15**	**..**	**-0.7**	
Turkey	1	6	7	1	1.2	Koc Holdings, Sbanci Holdings, Enka
South, East and South-East Asia	**61**	**608**	**703**	**95**	**3.4**	
China	4	37	39	2	0.2	Sinopec, CNOOC, Haier, Hua Wei Technologies, TCL, Lenovo
Hong Kong (China)	12	340	406	66	57.0	Hutchison Whampoa, Li & Fung
Republic of Korea	2	35	39	4	2.0	Samsung Electronics, LG Electronics, Hyundai, POSCO
Taiwan Province of China	30	84	91	7	10.9	Acer, Farmosa
South Asia	**..**	**6**	**8**	**2**	**0.9**	
India	..	5	7	2	1.0	Afteck Infosys, Roto Pumps, B4U Multimedia Int., Cipla, ACE Laboratories
South-East Asia	**11**	**107**	**120**	**14**	**5.9**	
Malaysia	3	12	14	2	7.7	Petronas, Malayan Banking, Telekom Malaysia, Hong Leong
Singapore	8	90	101	11	25.4	Singapore Airlines, Neptune Orient Lines, SingTel, Keppel Corp., Capital Land, Pacific Int. Lines, Sembcorp Industries, Hong Leong Asia, CDL, DBS Group
South-East Europe and the Commonwealth of Independent States	**0.2**	**77**	**86**	**10**	**5.9**	
Russian Federation	..	72	82	10	9.1	Lukoil, Novoship, Norilsk Nickel, Primorsk Shipping , Far East Shipping
Developing economies as percentage of world	**7.3**	**10.6**	**10.6**	**10.8**	**..**	

* Gross fixed capital formation.

Source: UNCTAD, FDI/TNCs database.

Africa

South Africa[4]

8. South Africa is the single largest source of OFDI from Africa. Its OFDI stock reached $29 billion in 2004 and accounted for 67 per cent of the region's OFDI stock (see table 1). Transfer of company listing to the London Stock Exchange, acquisition of assets in Europe, and subsequent liberalization by the government played a key role. OFDI has been driven largely by investment in resources as well as by investment opportunities in neighbouring countries as a result of privatizations (e.g. in Mozambique). Notable success stories of South African TNCs include AngloGold Ashanti (gold production), Illovo Sugar (sugar production in South Africa and neighbouring countries), Mondi (paper production), Steinhoff (furniture manufacturing) and the MTN group (cellular phone services). Most of the enterprises that have internationalized are large firms in resource and finance industries. However, small- and medium-sized South African enterprises are also investing abroad (e.g. Spanjaard Ltd., Metorex, DPI Plastics).

Asia-Pacific

9. Enterprises in Asia are investing abroad more than those of any other developing region, and are contributing to an OFDI stock that stood at $718 billion in 2004. Enterprises from many economies in East Asia and Southeast Asia are internationalizing further and faster through OFDI.

China

10. The rapid rise of China as a source of OFDI has been noteworthy. A significant proportion of its OFDI value is in resource extraction activities (oil, natural gas and minerals) dominated by state-owned enterprises. To date there has been little manufacturing abroad. Investments in services are growing: OFDI in computer-related industries, information technology and trading activities accounted for the lion's share of Chinese OFDI stock in 2003. Not just large Chinese enterprises but SMEs too are investing abroad.[5] Most Chinese OFDI is directed towards other developing countries, not only in Asia but also in Africa and Latin America (UNCTAD 2003). OFDI examples include such enterprises as Haier in white goods industries and Huawei Technologies in electronics and IT activities. These enterprises have also invested in overseas R&D centres (e.g. in India, Sweden, Singapore, the United Kingdom and the United States). Other electronics and IT companies have made acquisitions abroad; examples are the merger of TCL with the TV and DVD operations of Thomson in France and Lenovo's acquisition of IBM-PC.

India[6]

11. India too has emerged as a significant source of OFDI, particularly in IT (Wipro and Infosys), manufacturing (Tata), pharmaceuticals (Ranbaxy) and natural resources (ONGC-Videsh) (UNCTAD 2004a, Pradhan 2004). Many Indian SMEs are also expanding abroad, like Roto Pumps (transport equipment). Other SMEs with successful overseas ventures include B4U Multimedia International (which has music and entertainment channels in 50 countries), Cipla Ltd. (a small drug manufacturer) and ACE Laboratories (a pharmaceutical firm). Half of India’s OFDI in 1999-2004 was in manufacturing (especially fertilizers, pesticides and seeds, drugs and pharmaceuticals), followed by non-financial services, including IT services and business process outsourcing. Building brand names has been a driving factor in such acquisitions as Daewoo Commercial Vehicle by Tata Motors, Infosys Technologies’ acquisition of Expert Information Services (Australia), and Ranbaxy Technologies’ acquisition of RPG Aventis (France). Indian call centres and business process outsourcing companies

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[4] For more details on OFDI from South Africa, see TD/B/COM.3/EM.26/2/Add.5.
[5] See "How can Chinese enterprises go overseas?" (in Chinese), http://www.chinaus.net/3318.htm.
[6] For more details on OFDI from India, see TD/B/COM.3/EM.26/2/Add2.

are now setting up foreign affiliates in the Philippines and Mexico, accessing specific labour talent, language skills, cost advantages and markets. Aftek Infosys is a good example of a transnational SME using overseas mergers and acquisitions to acquire firm-specific resources and expand the customer base.

Republic of Korea

12. Until the 1990s, OFDI from the Republic of Korea was heavily restricted and was largely limited to resource development. With liberalization in the mid-1990s, OFDI began to take off, only to be stymied again by the 1997 financial crisis. After the crisis, Korean enterprises rapidly built up their OFDI, led by large TNCs such as Samsung Electronics and LG Electronics. Since the 1997 financial crisis, there has been evidence of a greater role by SMEs in Korea's OFDI (OECD 2004); they accounted for an annual average of 37 per cent of Korea's OFDI flows in 2000–2004 (see table 2). SMEs have been aided by institutional initiatives such as the iPark ventures in Silicon Valley, which enable small Korean IT firms to establish themselves in overseas markets. Similar facilities are planned in Beijing, Boston, London, Shanghai and Tokyo (Thurbon and Weiss 2005).

Table 2. Republic of Korea: OFDI flows by SMEs, 2000–2004
(millions of dollars)

	2000	2001	2002	2003	2004	2000-2004
Total OFDI	6 074	6 353	6 332	5 906	8 053	6 544
OFDI by SMEs	2 867	1 339	2 220	2 557	3 074	2 411
Share of SMEs (%)	47.2	21.1	35.1	43.3	38.2	37

Source: Export-Import Bank of Republic of Korea, www.koreaexim.go.kr.

Singapore[7]

13. The top 12 TNCs from Singapore include seven government-linked companies (GLCs). In fact, all top five are GLCs in such strategic industries as air transport, shipping, telecommunications, shipyards and shipbuilding, and property development. A number are family-owned enterprises, including Pacific International Lines (shipping), Hong Leong Asia (industrial) and City Developments Ltd. (property development and hotels). Neptune Orient Lines, SingTel and Hong Leong Asia have a very high proportion of their sales and assets outside Singapore, owing to their heavyweight subsidiaries abroad and their globalization strategies. Singapore SMEs such as Rayco Technologies (a manufacturer of synthetic rubber for the electronics, data storage, automotive and medical industries) and HTL International (a furniture manufacturer) have also grown through internationalization. These enterprises have operations in neighbouring countries such as China and Malaysia. Other Singapore SMEs, such as Autron Corporation Ltd. (an equipment supplier to China's electronics industry), have strengthened their overseas market position and presence through selected acquisitions.

Thailand

14. Thai companies have been investing abroad, mainly in neighbouring ASEAN countries and China but also as far as the United States and Europe to expand markets and access to natural resources. Charoen Pokphand, a domestic conglomerate that formerly focused on agribusiness, has expanded its business internationally with investments to such countries as China and Indonesia. Siam Cement, a construction materials company, has invested abroad in petrochemicals and construction materials. Banpu Group, a coal and electricity company, has mining operations in Indonesia and China. Bumrungrad Hospital, a health services company, has extended its services to neighbouring countries.

[7] For more details on OFDI from Singapore, see TD/B/COM.3/EM.26/2/Add.3.

Saha Union Group, a conglomerate of 58 companies focusing on textile products, and Mitrphol Sugar, which deals in sugar products, have activities in China. Many banking companies such as Bangkok Bank have operations in a number of ASEAN countries.[8] The Government of Thailand has been encouraging and supporting OFDI by Thai companies. In particular, the Thai Exim Bank and the Board of Investment have been providing facilities (e.g. information, outward investment missions) to help Thai firms venture abroad. ASEAN investment cooperation and the Greater Mekong Subregion[9] arrangement have also encouraged Thai OFDI to member States.

Latin America and the Caribbean

15. Latin America and the Caribbean are the second largest source of OFDI from developing regions. Excluding the Cayman Islands and the Virgin Islands, which are offshore tax havens, Brazil, Argentina, Mexico and Chile (in that order) are the dominant investors in the region.

Argentina[10]

16. There is notable OFDI from Argentina. Tenaris Siderca (steel) is one of the successful Argentine companies investing abroad and is developing a global production network for seamless steel pipes. It is also a leading regional supplier of welded steel pipes for gas pipelines in South America, with overseas manufacturing facilities in Brazil, Canada, Italy, Japan, Mexico, Romania and Venezuela. Argentine software SMEs such as Idea-Factory, Cubika and Sistemas Estratégios S.A. have also invested abroad.

Brazil

17. Brazil is a leading investor in developing countries. Brazilian firms have been investing mostly in primary industries such as energy and mining, led by Petrobras in oil and energy (UNCTAD 2004a). Some Brazilian firms invest abroad to enhance their capabilities and reach, such as Odebrecht (construction), Gerdau (steel) and Ambev (beverages).[11] Some invest abroad for financial motives. The Government of Brazil has taken a positive approach to OFDI, and President Luiz Inácio Lula da Silva has set a target of 10 Brazilian firms becoming true TNCs by the end of his first term. In May 2004, he led an investment mission of 500 Brazilian business entrepreneurs to China.

Colombia

18. Colombian companies have invested abroad in various market niches in Latin America by exploiting their brand names. They have expanded overseas through acquisitions. Some of these companies include Nacional de Chocolates (food), Organización Corona (ceramics) and Federación Nacional de Cafeteros (coffee) (UNCTAD forthcoming).

Transition economies: Commonwealth of Independent States (CIS)

19. The transition economies are beginning to engage in outward FDI (Andreff 2003). Since the 1990s, most OFDI in the region has come from the Russian Federation.

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[8] Includes Brunei Darussalam, Cambodia, Indonesia, the Lao People's Democratic Republic, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam.

[9] Includes Cambodia, the Lao People's Democratic Republic, Myanmar, Thailand, Viet Nam and Yunnan Province, China.

[10] For more details on OFDI from Argentina, see TD/B/COM.3/EM.26/2/Add.1.

[11] Ambev has established a “trans-Latin” network of beverage and food production and recently concluded a deal with Belgium's Interbrew to create a new global brewing and beverages giant, InBev AS, based in Belgium.

Russian Federation[12]

20. Driven by the internationalization of the country's oil and gas companies, Russian OFDI is becoming substantial. Most Russian OFDI has been in energy- and mining-related industries, including oil refining and oil and gas distribution. Major outward investors include Lukoil, Gazprom, Novoship, Norilsk Nickel, Primorsk Shipping Corporation and the Far East Shipping Company. While their numbers are small, Russian SMEs have also invested abroad in neighbouring countries and Europe in IT and telecommunication activities. For instance, the LCS Group (IT) has invested in the United Kingdom as part of its corporate expansion and market access strategy. Galaktika (also IT) has done the same by investing in the CIS markets (Kazakhstan, Ukraine).

Drivers and motivation of OFDI

21. As UNCTAD case studies indicate, goals of developing-country OFDI include accessing strategic assets and new markets, accessing technologies and acquiring brand names or R&D facilities. Other motives include securing natural resources and increasing efficiency, as well as financial reasons.

22. The drivers of OFDI from developing countries fall into two broad groups:

Macroeconomic and home country policy environment. This includes such factors as home market growth constraints, liberalization and currency appreciation. Important drivers include improvements in the home country OFDI regulatory framework, capital account liberalization (relaxed exchange controls), signing of trade, investment and taxation treaties, and incentives (e.g. tax rebates and investment insurance for OFDI) by home governments.

Corporate-specific reasons. These include:

- Push factors (e.g. rising costs in the home market, following competitors and suppliers, corporate internationalization policy)
- Pull factors (e.g. growth opportunities, investment opportunities in the host country, lower production costs, availability of natural resources, host government incentives)
- Management factors (e.g. availability of skills and knowledge needed to internationalize successfully)
- Chance factors (e.g. being invited to supply a customer abroad)

23. The case studies suggest that the motivations behind OFDI differ across industries (resource base vs. IT), host locations (geographical proximity, historical ties, cultural affinity), enterprise size (large companies vs. SMEs), orientation (asset and resource seeking, market seeking, efficiency seeking), market entry strategy (M&As, asset swapping, greenfield investment) and types of institutions (private enterprises vs. state-owned enterprises).

24. Many Chinese, Indian and Russian companies are investing abroad to access strategic assets and natural resources. Efficiency-seeking and asset-augmenting OFDI tends to go to locations that can increase competitiveness with regard to cost, technology, management skills and brand names (see box 1). Market-seeking OFDI is driven by the competitive impulse to access new markets, distribution networks and marketing channels in order to secure greater influence over supply chains. By extending their value chains into low-cost locations, developing-country firms are investing in other developing countries (e.g. Singaporean manufacturing companies building their investment in Indonesia, Thailand and Viet Nam, or textiles and clothing companies extending their activities to Cambodia and parts of Africa to take advantage of low-cost production). The use of cross-border M&As as a market entry strategy has increased for resource-seeking and asset-augmenting OFDI.

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[12] For more details on OFDI from the Russian Federation, see TD/B/COM.3/EM.26/2/Add.4.

Box 1. OFDI motives of selected developing-country firms

Market-seeking OFDI

Roto Pumps Ltd., an Indian transport equipment company, used OFDI to build marketing subsidiaries and warehouses overseas (Kenya, United Kingdom, Australia and several South-East Asian economies) to expand its market.

Mobile Telesystems (MTS), the largest Russian mobile operator, has operations in the CIS countries. It used its first mover advantages to gain access to the markets of neighboring economies.

Spanjaard Ltd., a medium-sized South African company in the chemicals sector, has opened subsidiaries in Zimbabwe and the United Kingdom to diversify its operations and expand markets.

Farmacias Ahumada, a Chilean pharmacy chain, began internationalizing in the mid-1990s to access new markets and expand its customer base. It has done so through using different strategies, from greenfield operations (e.g. in Peru) to acquisitions of chains in Brazil and Mexico. More than 70 per cent of its customers today live outside Chile.

Technology-seeking OFDI

Ranbaxy, a leading Indian pharmaceutical company, has established subsidiaries around the world (United States, United Kingdom, Germany, France, Spain, Ireland, Netherlands, India, China, Brazil, South Africa, Japan, other countries). Its OFDI motives are diverse, ranging from acquiring brand names and technologies to increasing its customer base.

Superhouse Ltd., an Indian footwear enterprise, has demonstrated that even medium-sized players from developing countries are internationalizing their innovative activities and benefiting from it. It has invested abroad to access technology and has development and design centers in Italy and the United Kingdom.

Yue Yuen, a Hong Kong–based footwear TNC, invested in China and Viet Nam in the 1990s to carry out R&D. It is among the 700 largest R&D spenders worldwide (DTI, United Kingdom 2004). **Huawei Technologies** (China) and other Chinese electronics companies such as **Haier** have set up R&D centres abroad.

Resource-seeking OFDI

RusAl, a Russian resource company, recently acquired part of Queensland Alumina in Australia (the world's largest alumina refinery) in order to gain access to natural resources. **Lukoil**, the Russian Federation's leading private TNC, has invested abroad to access export markets and natural resources.

Metrox, a midsized South African mining company, has subsidiaries in several countries such as Burkina Faso, Zambia and the Democratic Republic of Congo. These resource-seeking investments were made to access key minerals such as copper, zinc and cobalt.

A number of **Chinese companies** such as **CNOOC, CNPC, PetroChina, Sinopec** and **Minmetal** and Indian companies such as **ONGC-Videsh** have invested in various host countries in order to access minerals, oil and gas.

Strategic-asset-seeking OFDI[a]

This type of OFDI is usually conducted through M&As to acquire brand names and strategic production facilities, including access to technology. For instance, **Tata Tea's** (India) acquisition of Tetley Tea (United Kingdom), the acquisition of Daewoo Commercial Vehicle Company (Republic of Korea) by **Tata Motors Ltd.** (India) for brand names. **Lenovo's** (China) acquisition of IBM's personal computer division (United States) and the merger of the television and DVD operations of **TCL** (China) with Thomson (France) are further examples of strategic-asset-seeking OFDI for acquiring brand names, production facilities and technologies. The **Shanghai Automotive Industry Corp**. has significant investment overseas, including in a GM-Daewoo project and a joint venture with Volkswagen. These investments were made primarily to gain access to technology and brand names.

[a.] Strategic-asset-seeking FDI is investment to increase or enhance the *existing* competitive advantages of a firm by acquiring or accessing *new* competitive advantages (Dunning and McKaig-Berliner 2002: 7).

Sources: UNCTAD case studies on OFDI; United Kingdom, DTI 2004; Sauvant 2005.

25. While the reasons for investing abroad are largely the same for SMEs as for bigger firms, the relative importance of the different factors may vary. In particular, while SMEs can be found in all these types of OFDI, they tend to congregate in market-seeking and efficiency-seeking activities. SMEs are more inclined to invest abroad for supporting trade channels and operating closer to home, often in neighbouring countries. SMEs that invest abroad are usually more growth-oriented and already have some international experience. The exception is high-technology SMEs, which more often start investing abroad despite a lack of international experience (UNCTAD 2005c). Because of their size and limited financial resources, SMEs are less inclined to pursue an M&A strategy in entering foreign markets than larger enterprises. Some SMEs follow TNCs as their supplier firms in going abroad.

OFDI and enterprise competitiveness

26. In a rapidly globalizing world, companies can no longer count on their home markets as a relatively secure source of profits. Competition from foreign firms is everywhere – through imports, inward FDI and non-equity forms of participation. These conditions make it all the more important for firms to pay attention to their competitiveness (Sauvant 2005: 16). OFDI is an important aspect of this consideration and a vehicle for integrating developing-country firms into the global economy.

27. The benefits of internationalization for increasing enterprise competitiveness are demonstrated by the evidence in UNCTAD's country case studies. They are also suggested by the fact that more enterprises are investing abroad and more countries are encouraging their firms to do so. In particular, OFDI has helped enterprises increase their revenues, assets, profitability, market reach and exports. In Singapore, some two thirds of the 204 companies surveyed agreed that OFDI had increased their enterprise competitiveness by improving market access, strengthening market position, increasing the company's international image, and increase familiarity with and experience in conducting international business. In South Africa, companies such as Illovo Sugar and MTN Group saw profits increase as a result of OFDI.

28. The Argentine cases suggest that OFDI has contributed to the expansion of companies' resources, strengthening of sales and exports, better management of risk through geographical diversification of assets, increased efficiency in suppliers, improvement in productivity and quality standards driven by demands of global customers, and facilitated technology transfer owing to mobility of human resources. These benefits can increase the overall value of a business. Similarly, OFDI has increased the strategic assets and revenues and strengthened the market position of Russian enterprises, including efficiency gains from control of supply chains and access to natural resources.

29. India Ispat was able to grow rapidly through its internationalization via the Periphery (starting in the Caribbean), and as it internationalized it was able to attract large, globalized customers such as steel users in the automotive industry, including General Motors. Thus its rapid internationalization was the prerequisite for being able to attract such global customers, and its late arrival on the world scene enabled it to test new technologies (for example, in the case of direct reduced iron enterprises). OFDI has helped Indian enterprises, particularly SMEs, increase their export competitiveness and R&D intensity, strengthened their trade support and marketing channels, and contributed to skills upgrading.

30. In the case of Cemex (Mexico), it was the firm’s rapid internationalization in the 1990s through the Spanish-speaking parts of the world that gave it a global perspective, reinforced through its innovative use of technologies (e.g. global positioning) systems that were unknown in the cement industry at the time.

31. Both Ispat and Cemex enhanced their competitiveness through internationalization. Indeed, they were the firms that globalized their industries – steel and cement – and, while starting out as SMEs, grew very large very quickly and thus assumed early on the characteristics of a global corporation, thinking and acting globally as they internationalized.

32. Another study found that Indonesian firms that invested abroad improved their performance dramatically in terms of management expertise, exports, quality and assets relative to their past performance and to the performance of firms in the sample that did not make such investments (Lecraw 1993).

33. As developing-country firms become more competitive through OFDI, they can contribute to the competitiveness of their home countries by increasing national productive capacity and productivity. For instance, investing abroad may be necessary in order to market a product or services in a host country and to sell it more effectively there. While this applies to many "non-tradable" services, it may also be relevant for manufactured goods that need adapting to local conditions (UNCTAD 2005: 9-10). In this regard, OFDI is likely to complement home country production. Securing access to natural resources could have complementary effects on home country operations and increasing productive capacity. Access to new technologies can increase the productivity, knowledge transfer and management skills of the investing company in its home country.

34. Larger enterprises from developing countries have internationalized more than SMEs in terms of transaction value. Reasons for this include their relatively greater ability to take risks, their better access to finance, and their maturity and readiness to internationalize. Internationalization benefits larger firms as well as SMEs. Much depends on a firm's strategies, motives and capacity to exploit advantages through internationalization.

35. In particular, the evidence indicates that SMEs can benefit from engaging actively with the international economy through their own OFDI activities, as a means of strengthening their linkages with other global players and thereby enhancing their revenues, capabilities and market access (Acs et al. 1997). The days when SMEs needed to become big players before embarking on international expansion seem to be over; this is one of the main results of globalization.

36. It is argued that OFDI from SMEs has the potential to increase the international competitiveness of the SME sector of both home and host countries. Greater flexibility, better capacity to serve small communities, relatively labour-intensive technologies and greater adaptability to local economic conditions can in some cases make SMEs better suited to conditions in other developing countries than TNCs (Dhungana 2003). For example, studies show that for Asian SMEs the length of time required to establishment initial international activity is 0.7 years, compared to 3.9 years for large firms (UNCTAD 1998).

37. It is also argued that OFDI from SMEs is more likely to lead to multiplier effects in terms of technology and knowledge transfer and productivity increases through linkages to local industry (UNCTAD 1998). Furthermore, it can strengthen the entrepreneurial base in the host country by providing local entrepreneurs with management skills and new experiences. It can also help fill the "missing middle" by promoting the growth of medium-sized enterprises.

Obstacles to OFDI

38. Traditionally, an overwhelming obstacle for firms wishing to internationalize has been the issue of scale. There is an “enduring logic of industrial success” that favours large firms (Chandler 1990). Achieving greater scale and scope through internationalization was the key to US and German success in the nineteenth and early twentieth centuries in such industries as chemicals and dyestuffs, electrical equipment, automotive engineering and telecommunications.

39. Thus, first-wave enterprises from the developing world encountered the obstacle of large, well-resourced incumbents and the industrial value chains that sustained them. But with the rise of globalizing tendencies in the 1980s and 1990s, and the possibilities created for linkage with global firms, e.g. as contractors for manufacturing or for business process outsourcing, size became less of a barrier. Second-wave firms include both SMEs and large companies, and both can take advantage of the “plethora of interfirm arrangements” found in the global economy (UNCTAD 2000: xv).

40. What constrains the capability of firms to internationalize is not so much the opportunities available as the inherited policy settings in the developing countries themselves. There are limits to outward investment, lack of insurance for outward investment, and exchange rate controls. The additional risks of investing and operating in a foreign country have hampered OFDI by developing-country firms, as have the lack of information on overseas investment opportunities and the lack of access to finance.

41. Internationalization can itself become a barrier if it does not happen fast enough. Many firms go through a traditional and incremental process of first exporting, then building up an agency in the host country before moving to local production, marketing and customer support. This pattern was followed by Scandinavian TNCs expanding abroad in the late nineteenth century and early twentieth centuries (Johanson and Vahlne 1977). For latecomer enterprises, the process appears to move faster and to involve applying learning acquired from one market in the next (Mathews 2002).[13]

42. Internationalization – particularly the accelerated version characteristic of internationalizing SMEs from the developing world – is risky and requires well-thought-out strategies and management skills. Not all attempts to internationalize will succeed. Companies that try to seize all investment opportunities that come along may not achieve synergies or improve their chances of meeting overall corporate objectives. Some OFDI leads to losses instead of profits, especially if the assets acquired are overpriced or not in the acquirer's core area of business. When internationalizing, enterprises should not spread their resources too thin, generating excessive operational and financial risks and burdening the business's overall operations.

43. The case of Acer (Taiwan Province of China) is instructive. Founded as a tiny company in 1976, Acer began internationalizing, in response to export interest in its PCs, in the late 1980s. But it moved too rapidly, making acquisitions in the United States and Europe that were financially draining, so that it nearly went bankrupt. New leadership in the early 1990s, and a new approach to internationalization as an incremental process involving partnership as the means of market entry, saved the company and unleashed a period of rapid international growth (Mathews and Snow 1998).

44. SMEs investing abroad encounter a number of obstacles. The problems exist within the firms themselves as well as in the host and home countries. Common internal obstacles are lack of international experience and management skills. Lack of information on investment opportunities and the host investment environment (including unfamiliarity with the legal system and OFDI regulations in the host country) is a more serious problem for SMEs than for large companies. Limited access to finance and cultural differences also hinder OFDI by SMEs, as does difficulty in finding suitable joint venture partners. Since the majority of OFDI by SMEs is in the form of joint ventures, it is important that host countries encourage the development of their SME sector so that local enterprises have the capability to form strategic alliances or joint ventures with investing SMEs from abroad (Cho 2003, UNCTAD 1998).

Policy measures that support OFDI

45. The policy environment that supports OFDI in general has improved. A number of developing-country governments have introduced OFDI policy, and some have made statements specifically encouraging their enterprises to internationalize through OFDI. For instance, the Government of Singapore announced 2004 as the year of internationalization, the Government of China established a policy of “go global” in 2000, President Luiz Inácio Lula da Silva urged Brazilian entrepreneurs to “abandon their fear of becoming multinational businesspersons” in 2003,[14] the Government of India has

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[13] This pattern, however, does not apply to most services investments. This is because most services are not tradable and they need to be produced when and where they are consumed (UNCTAD 2004b).

[14] President Lula’s address to the Portuguese Industrial Association, Lisbon, 11 July 2003.

specifically encouraged Indian enterprises to go global,[15] and South Africa's Government has encouraged enterprises to invest abroad. (In the 2001 budget, the country's Finance Minister wrote, “The global expansion of South African firms holds significant benefits for the economy – expanded market access, increased exports and improved competitiveness.”[16]

46. Improvements in the regulatory framework played an important role in supporting the increased internationalization of developing-country firms. Some developing countries with restrictive regimes, such as China, India, South Africa and Turkey, have taken steps to liberalize and relax exchange controls that augur well for OFDI. Early efforts that restricted OFDI insisted that borrowing was to be done abroad and earnings were to be reinvested, or that plants and equipment were to be used as contributions of capital in kind. Other supportive measures include streamlining OFDI approval procedures and the conditions governing equity ownership of affiliates abroad.

47. Some developing countries have gone beyond liberalization to active promotion – for example, providing institutional support to help their firms internationalize and organizing OFDI missions to target host countries (Malaysia, Thailand). Countries such as Singapore and the Republic of Korea have supported the creation of foreign enclaves such as industrial parks in host countries. Some even provide incentives and market intelligence information to encourage internationalization of their firms (Singapore). Countries such as China, India and South Africa have simplified their approval processes and raised the investment permit ceiling to make OFDI easier. Some countries have private-sector cooperation and networking to promote South-South investment (Malaysia) and investment in other countries (Singapore).

48. Developing-country governments have also increased the number of concluded bilateral investment treaties (BITs) and double taxation agreements and, more recently, bilateral and regional free trade and investment agreements. (Examples are the ASEAN Investment Area Agreement and the South Asia Free Trade Area.) To the extent that these agreements protect investment and open up industries for FDI, they facilitate OFDI from developing countries.

49. Indeed, many developing countries are carefully adjusting their negotiating positions in international investment agreements (IIAs) to reflect the fact that they are no longer only receiving (host) countries but also increasingly source (home) countries. With more and more developing-country firms internationalizing, this trend can be expected to continue and possibly accelerate. Questions that need to be addressed in this context are how to adequately reflect the development dimension in IIAs that involve developing-country partners that are themselves home to TNCs, and how to devise provisions supporting OFDI from these countries. Examples of the latter could include provisions aimed at enterprise development, OFDI promotion programmes and outbound investment missions in conjunction with investment promotion authorities.

50. Home country governments, not only host governments, could provide institutional support such as market intelligence and information on investment opportunities in target host countries, including consultancy services to help their firms grow through OFDI. More importantly, developing-country (home) governments can enhance the ability and capacity of their countries' enterprises, particularly SMEs, to internationalize through OFDI. A dedicated OFDI agency can help. Such institutional support can also help developing-country firms, particularly SMEs, overcome their fear of venturing overseas. Other services that home governments could provide include OFDI risk insurance and making SMEs aware of BITs and bilateral and regional free trade agreements that contain investment provisions. Regular seminars on internationalization issues could include exchanges of experiences among companies (larger and smaller) that have been successful in internationalizing and those that have faced and overcome challenges in venturing abroad. Establishing an SME internationalization club could foster policy development and an environment that address the needs of SMEs. So could financial and fiscal incentives such as loans and support for feasibility studies and for encouraging SMEs to go abroad.

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[15] Speech given by Prime Minister Manmohan Singh at “The Indian CEO: Competencies for Success Summit”, 22 January 2005.
[16] Budget Speech, Trevor A. Manuel, Minister of Finance, South Africa, 21 February 2001.

51. The lack of statistics has hampered analysis of the internationalization strategies of developing-country enterprises, particularly SMEs. Such statistical limitations restrict analysis of areas such as the potential benefits of IFDI, where developing-country firms invest, which industries have the most OFDI and which policies have worked or not worked. Developing-country governments could consider improving their statistical systems to ensure provision of such data.

52. There is room for developing-country enterprises, including SMEs, to improve their understanding of the benefits, risks and challenges of OFDI. Increased knowledge of cross-cultural matters and international management issues can mitigate the risk of failure. Networks, clusters, business schools and business associations can help transmit the necessary information and enhance the capacity of developing-country enterprises to internationalize:

- Linking with TNCs can help businesses, particularly SMEs, to upgrade their activities, access know-how and technology, and get direct or indirect exposure to the international business community. This process will strengthen their ability to undertake OFDI.
- Working in a cluster supports the deepening and broadening of knowledge, provides quality control and information related to markets and marketing, and helps establish appropriate linkages to a wider set of technology inputs and actors. Such an environment gives companies the information and capability they need to set up a foreign subsidiary.
- Networking with business schools should focus on strengthening managerial skills and building capacity in investing and managing international enterprises.
- Effective business associations can support the learning process and provide contacts and a forum for sharing experiences.

53. The international community can play an important role in supporting OFDI from developing countries. It can help with policy analysis, identifying best practices, networking, and raising awareness at the international level regarding the benefits, challenges, impact and steps to take to minimise the risks of going abroad by developing country firms. Investment promotion agencies for inward FDI and OFDI, both in developing and developed countries, could coordinate their efforts. For example, international organizations like the World Association of Investment Promotion Agencies (WAIPA) could coordinate such cooperation.

Conclusion

54. Internationalizing firms from developing countries are pursuing strategies that enable them to catch up with established players, leveraging their latecomer advantages. These include being able to access strategic assets, new technologies and markets, deploying low-cost engineers in innovative ways, mastering all aspects of manufacturing processes, and others.

55. The more global the world economy becomes, the greater the pressures on firms to globalize. This pattern of internationalization is very different from the one which drove earlier experiences, and which involved export expansion and trade promotion. Today internationalization appears to be driven much more directly by firm-to-firm contracting in a global setting, and it frequently involves SMEs initially being drawn into global business through contractual linkages with larger TNCs.

56. OFDI has desirable and undesirable effects. Governments wishing to promote enterprise competitiveness through OFDI should weigh its potential costs against its benefits to their economies and enterprises, and should then determine appropriate policy approaches. To the extent that developing-country firms become more competitive, and to the extent that the home economy keeps important aspects of its activities at home, it is likely to benefit from better connections to international markets, increased productive capacity, and more access to natural resources and strategic assets. On the other hand, there may be adjustment costs, especially social costs in the case of offshoring of labour-intensive activities. Therefore, in developing policy options, consideration should be given to maximizing the benefits of OFDI given the costs.

57. Recent years have seen growing attention to OFDI, including in the context of SME development. However, analytical and empirical evidence regarding the correlation between OFDI and enterprise competitiveness, especially SMEs, remains limited.

58. A number of key issues need to be addressed in order to deepen the analysis of this phenomenon and to identify feasible strategies and policy options with a view to enhancing the competitiveness of enterprises, particularly SMEs, through OFDI:

- How can OFDI benefit economic development?
- How does OFDI affect enterprise competitiveness, and how can it be measured?
- What are the best company practices in the area of OFDI, and what are their key success factors?
- What are the main obstacles to internationalization through OFDI, and how can they be removed?
- Are there any differences between OFDI by large companies and SMEs?
- What policy options could help maximize the development impact of OFDI for home countries by enhancing the competitiveness of their enterprises, both larger and smaller ones, through this means of internationalization?
- What role can the international community play in this regard?
- Does OFDI represent a channel for South-South cooperation in investment, should it be increased, and what measures can be used to do this?

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