Meeting of Experts on “FDI, Technology and Competitiveness”
A conference convened in honour of Sanjaya Lall

UNCtAd, Palais des Nations, Geneva
8-9 March 2007

Third World Multinationals Revisited

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Introduction

The study of so-call Third World Multinationals (TWM) – or what we will refer to as developing country transnational corporations (TNCs) in the United Nation’s terminology – is roughly 30 years old. Research on this topic has many roots and sources of inspiration, including papers from distinguished academics such as Ronald Scheman, Donald Lecraw, Louis Wells, Edward Chen, Raj Agarwal and some others.1

Among the leaders in this pack was a relatively young Sanjaya Lall. As far as we can determine, his earliest published works on this topic are an article in the Journal of International Affairs and a chapter in an edited book by Giersch, both appearing in 1979. Soon after this, among other papers, he published an article in World Development in 1982 on Indian joint ventures, followed by another more general one in Third World Quarterly in 1983. Also in 1983 he published an edited book with John Wiley on “The New Multinationals”.2 Of course, he continued to work on this theme until his untimely passing in 2005, especially in the context of his undeniably impressive research, publications and policy advice on East and South Asia; but these early publications were seminal pieces that framed much of his later thinking on the issue. Having said this, arguably, his focus shifted inexorably from the mid-1980s away from TWM’s, as such, to other aspects of economic development, with his last detailed piece on the subject being published in Banca Nazionale del Lavoro Quarterly Review in 1991. (Although two reports published by UNCTAD, in which he was a key member of the team, were also focused on TNCs from East Asian developing countries (as well as Japan)).3


We will return to how, why, and to what extent, Lall’s worked evolved from TWMs – the double meaning in this sentence being intentional.

As it happens, the UNCTAD World Investment Report 2006 (WIR 06) focused on Transnational Corporations from Developing and Transition Economies, which allows us the opportunity to compare Lalls’s ideas on this issue from the early 1980s to the current situation. Hence the theme of this paper, “Third World Multinationals Revisited”, with the following sections examining, in order, the rise and evolution of developing country TNCs, their motives and competitive advantages, and strategies.

The rise of foreign direct investment by developing country TNCs

Lall’s mood when describing and investigating the phenomenon of developing country TNCs was upbeat. While cautious in his analysis and nuanced in his thinking about the value of outward foreign direct investment (FDI) for developing home countries, he was nevertheless optimistic about the prospects and delighted at the potential implications for development. His optimism was indeed correct, but the proof was a decade or more in coming, with developing country FDI not “taking off” until the late 1980s or early 1990s, as illustrated in figure 1 below. By 2005 the share of FDI from developing and transition economies had reached 17% of global FDI flows (or $133 billion) and UNCTAD’s projections are that this share will continue to rise. The value of the stock of FDI from developing and transition economies was estimated at $1.4 trillion in 2005, or 13% of the world total (and about 10 times what it was in 1990). As recently as 1990, only six developing economies reported outward FDI stocks of more than $5 billion; by 2005, that threshold had been exceeded by over 20 developing and transition economies. In that year, apart from Brazil and South Africa, the largest developing home countries are concentrated in Asia, with Hong Kong (China), Singapore and Taiwan Province of China leading the pack (table 1). Other significant developing source countries include Argentina, Chile, China, India, Malaysia, Mexico, Republic of Korea and Turkey (WIR 06). The rise in the number of large TNCs from developing and transition economies is a reflection of rising FDI. For example, in the year 1990 only 19 companies based in developing and transition economies featured in the Fortune-500 list of the world largest companies; by 2005 that number had risen to 47 and reached 58 in 2006.

As Lall would undoubtedly have said (in fact, he actually said it!), the rise of FDI and TNCs is not a flash in the pan, although “special factors” such as high commodity prices providing companies with additional investible funds have played a role. Developing and transition economy companies are in the top 20 of virtually every industry in the lexicon - and even in the top 5 in a number of cases. Examples include, CVRD (Brazil) in mining, Hyundai Motors (South Korea) in cars, SABIC (Saudi Arabia) in chemicals, Hon Hai Precision (Taiwan) in electronics, Lukoil (Russia) in petroleum refining, Baosteel (China) in steel, Tata Consultancy Services (India) in software services, and America Movil (Mexico) in telecommunications (WIR 06). These TNCs (and governments) are recognising that fundamental forces such as global competition and international opportunities, the Janus face of globalisation, are a persistent phenomenon. In consequence their view of business has become internationalised and their ambitions are increasingly regional or global in scope. This transformation, from a domestic vision to an international one, underscores the nature of the structural shift which has occurred in the global economy. It partly explains why these companies are so much in the news, as they seek out opportunities in both industrialised and developing economies.

As Lall predicted (at least in his most optimistic moments), and as stressed in last year’s World Investment Report, the rise of developing and transition economy TNCs reflects an extensive, profound shift in the structure of the world economy. From a low point some time in the mid-20th century, the share of developing countries in global GDP - and more particularly Asia -has risen steadily and this ratio is now accelerating.
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The characteristics and competitive advantages of developing country TNCs

So, developing country TNCs have “arrived” and are here to stay. How do they compare in type to the phenomenon that Lall was describing in the early 1980s? Noting the importance of manufacturing FDI by newly industrialising economies (“...and India” in his parlance) from Asia and South America (as is still the case today), he nevertheless recognised the burgeoning importance of TNCs in services such as banking, real estate and trading. As late as 1990, 53% of developing country FDI stock was in manufacturing; however by 2005 the situation had more than reversed, 85% of the stock of FDI being in services. The share of the primary sector is also on the rise, but primarily in the last few years. In 2005, the most significant industries by FDI stock were business services, finance, “infrastructural services”\(^4\), “trade”, the electrical and electronics industries, chemicals and metal products (WIR 06).

Apart from the development implications of the phenomenon, the most important thing that Lall was trying to explain was how “[developing country] firms appear to be entering much ‘higher’ levels of skill, size, capital intensity than current thinking allows for”, adding that “the line between them and ‘real’ [TNCs] should be drawn more carefully” (Lall 1982). In other words, how is it that developing country TNCs exist and in what ways do they differ from their developed country counterparts? It is worth saying, at this stage, that though Hymer’s monopolistic advantages theory had been around for a while, Lall was also drawing inspiration from other then recent theories and approaches, including Buckley and Casson’s use of the internationalisation hypothesis to explain the creation of TNCs and Dunning’s fledgling eclectic synthesis of a number of approaches (including monopolistic advantages and internalisation). His main approach to understanding the existence of developing country TNCs was to concentrate on the dynamic processes in the growth and development of firms. Underpinning his model was the notion of revealed comparative advantage (RCA) in the home economy, translated or appropriated into the monopolistic advantages of particular developing country TNCs.

In this respect, Lall’s approach is not fundamentally different to the one adopted in WIR 06. He applied this model to Indian joint ventures abroad, as well as to Korean and other East Asian countries – and was able to explain outward FDI in certain industries, such as electronics and garments, in terms of technological capabilities amassed by companies during a period of growth and development. What he could not have anticipated at the time is the current scale and diversity of FDI by developing country TNCs in a wide variety of services, including power, ports and telecommunications. When he was writing on the topic, these were industries very much in the purview of states in both developed and developing countries. Today, after rapid global liberalisation in these activities, FDI in infrastructures is large, conducted by both developed and developing country TNCs (including TNCs which are still state-owned) – and, interestingly, both types of TNCs are on a closer competitive footing than might be expected.

\(^{4}\) For example, transportation, utilities and telecommunications.
How well do Lall’s insights of the early 1980s about the nature of developing country TNCs bear scrutiny when examining the phenomenon today? A useful way to do this is to see how well and to what extent the sources of TNC advantage he identified “map” onto an “extended” model of type and source of advantage we developed for WIR 06. As figure 2 shows, we cross-tabulated 4 types of advantage (“ownership and access”, “product/process & value chain niches”, “networks and relationships”, “organisational structures and business culture”) with three potential sources or loci of advantage (“firm-specific advantages”, “home country advantages” and “development process or stage of development advantages”). Of course, in addition to internally generating sources of advantage (e.g. proprietary technologies or production skills), the aim of firms is to transform home and development process advantages they may enjoy with other firms into firm-specific advantages, but this is not necessarily an easy process. At this stage we will not elaborate on the model further, but refer you to chapter IV of WIR 06!
Both Lall and the recent WIR survey of developing country TNCs (figure 3) find that the most important sources of advantage for developing country TNCs reside in the “product/process & value chain niche” quadrant of the WIR diagram (“A” in figure 3). Lall stressed, unlike some contemporary authors, that these advantages were not primarily based on cheap labour, but rather technical knowledge and expertise created for the purpose of specific manufacturing (and service) processes – and often relying on the created assets available in the home country. He used examples of TNCs from Argentina, Brazil, Republic of Korea and elsewhere to buttress this case. In the case of India he argued, “…it seems to have the most diverse, complex and technically advanced set of industrialising LDCs, with the highest local ‘embodiment’ of skills, capital goods and components” (Lall 1982). The notion of “embodiment” refers to the idea that TNCs can transform created and other home country assets into firm-specific advantages (“A → A” in figure 3), which is in keeping with our findings in WIR 06. Interestingly, as a precursor to latter day Indian TNCs, he also found that Indian technology exports displayed a similar “embodiment of assets” in turnkey industrial projects and consultancy services (Lall 1982).

Lall also argued that, “countries which have deliberately restricted access to foreign technology (but not cut it off altogether), such as India and Republic of Korea, have been able, after considerable ‘learning costs’, to assimilate an unexpectedly high level of technological ‘know how’, and this is reflected in their foreign activity” (Lall 1982). He recognised that developing country TNCs are able to develop ‘higher-level’ proprietary expertise and technology (“B” in figure 3), but this would be less the case than for developed country TNCs – the responses of TNCs from the WIR survey also bears this out. Lall used companies from the Republic of Korea as his main examples, with a few Indian examples. The WIR survey found that TNCs from many developing countries had developed such proprietary advantages.
in expertise and technology, but this was most likely for companies from the Republic of Korea, Taiwan Province of China, Brazil and India.

Though recognising that home country resources can be important (“C” in figure 3), he did not consider financial resources an important source of advantage, which is in contrast to the situation at present, with developing country TNCs from China to Dubai able to draw on funds arising from trade surpluses or high commodity prices. Lall’s perspective is, however, understandable given the circumstances and policies of developing countries in the 1970s and early 1980s. Moreover, while also recognising the significance of family-based industrial groups, he largely overlooked the importance of business models (“D” in figure 3) and networks as likely sources of advantage, something which came out very strongly in the WIR survey. In a similar vein, because of his stress on technology (and, for the most part, manufacturing), he did not pay as much attention to softer issues such as forms of governance, affinity based on kinship, culture or institutions (at least in his early work). However, case studies in the WIR show that all these aspects can be important in making developing country TNCs competitive.

It is remarkable how closely Lall’s insights and the WIR survey results map onto the framework of advantages depicted in figure 3, though something approaching two decades separates them. Both Lall’s research and the WIR results indicate that firm-specific production and process technologies are the single most important type of competitive advantage possessed by developing country TNCs (indeed, this view is common in the literature), which is in contrast (at least according to the paradigm) to developed country TNCs whose advantages are more likely to reside in ownership of expertise and technology. Of course, firms strive to transform advantages into proprietary ones, so developing country TNCs do possess monopolistic advantages in expertise and technology – but on average to a lesser degree and proportion to their developed country TNCs. Lall recognises the importance of access to created assets in the home country (which companies can internalise), but this does not come out as an important source of advantage overall in the WIR survey. However, the survey results underline the importance of business models and networks, which Lall recognises but does not put too much emphasis on. Beyond this, many of the quadrants in figure 3 appear to be empty.

However, this is a misapprehension. The types of potential sources of advantage are more diffuse and may not appear high on average, but nevertheless be critical for certain companies. In some cases these advantages may not be recognised because they are a part of the “environment” (e.g. a pool of cheap, highly qualified, readily available software engineers), or in other cases these advantages are not the “primary” ones, but rather they supplement other advantages to improve the overall competitiveness of a firm. This insight of “combination advantages” is crucial, it can be appreciated best from case studies and helps explain the specific strategies pursued by developing country TNCs. The case studies of Marcopolo, Hikma and Olam below illustrate how supplementary sources of advantage are utilised by these companies to improve their competitiveness overall.
Case study 1: Marcopolo

Marcopolo is a Brazilian bus and coach manufacturer that possesses proprietary technology and expertise (section 1 in figure 2) which it has built up since it was established in 1949. Until the early 1990s, it had pursued a policy aimed at servicing regional and northern markets, including an investment in Portugal. Thereafter, it reoriented its strategy to service niche markets, especially in developing countries (segment 6 of figure 2) and leveraged this strategy by means of institutional affinity (segment 12) and South-South intergovernmental initiatives (segment 9). This strategy has enabled it to sell buses in more than 80 countries and capture half of the Brazilian market and about 7% of the global market against strong competition from developed-country TNCs. Its success is based on: (a) its flexible production system (segment 4) enabling it to make tailor-made buses for clients – one of its strongest advantages; (b) focusing on the essentials – 70% of its revenue is accounted for by the bus body segments. Other parts of the bus are secured from parts makers and the chassis are bought from major TNCs such as Mercedes-Benz; (c) producing in low-cost locations that offer appropriate production clusters, such as Argentina, Mexico and South America, to keep prices affordable for developing-country customers; and (d) it’s efforts in creating brand loyalty (segment 7).
Case Study 2: Hikma Pharmaceuticals

Hikma pharmaceuticals is a Jordanian company which was established in 1978 to offer Arab countries cheap, diverse, high-quality pharmaceuticals, and thus was regionally orientated from the beginning, predicated on cultural affinity and South-South ties (segments 11 and 9 in figure 2). Cost was a primary consideration (segment 6); in addition, the company relied on the relatively highly skilled Jordanian labour force (segment 2) and the technology was sourced from licensors in developed countries, especially Fujisawa in Japan (now Astellas Pharma). It now enjoys a strong market position in West Asia and North Africa, and has expanded to other parts of Africa, Central Asia and Eastern Europe (a mix of segments 11 and 12), and, more recently, to the United States and parts of Europe. It now manufactures in two other Arab countries and Portugal, and has R&D centres in Jordan and the United States, thereby using the locational advantages of countries and facilitating its move to possessing knowledge-based proprietary advantages (segment 1).

Figure 5. Sources of advantage enjoyed by Hikma (Jordan), pharmaceuticals manufacturer.
**Case Study 3: Olam International**

Olam International was established in 1989 in Singapore with a view to managing the supply of agricultural products and industrial raw materials, mostly in Africa (e.g. Nigeria, Ghana and Côte d’Ivoire) and South-East Asia (e.g. Indonesia and Viet Nam). The group has a very well-defined business model that stresses networks and relationships in 32 developing and transition economies, as well as some developed countries (segments 7 and 10 in figure 2). Because the company is fully integrated from the “farm gate” to the “factory gate” (including 115,000 suppliers) this results in cost advantages, a risk management capability, and expertise in services such as traceability, hygiene and organic certification and inventory management (segment 1).

Neither Lall’s work nor the conceptual framework utilised in WIR 06 set out to challenge the foundations of existing theories (or syntheses of theories) on FDI or TNCs, rather they sought to extend and improve them by investigating the ‘limits’. In Lall’s case, as we will see, this may have led him deeper into investigating the generation of developing country firm advantages, competencies and competitiveness; and, beyond this, into a lifetime of distinguished work on the nature of the development process, the role of industrial policy in supporting the creation of technological and other capabilities in firms and nations, and the nitty-gritty of competitiveness. In the case of WIR 06, examining the nature of developing country TNCs has allowed us to extend a narrow conception of sources of competitive advantage to embrace a wider range (and within a systematic conceptual framework). This is important because our understanding of developing country TNCs is enhanced, both in terms of what they are and what they do. We recognise the truth in the lines, “There are more things...”
in heaven and earth, Horatio, than are dreamt of in your philosophy,” and realise that we are at the beginning of considerable more work on developing country TNCs. More heretically, the same may apply for developed country TNCs too.

The strategy and motives of developing country TNCs

Economic and political drivers that trigger the internationalisation of TNCs (or result in further overseas expansion) can be wide ranging, but include a small-scale home market (relative to a company’s operations or ambitions), competitive pressures (which are intensifying in an increasingly liberalised world) and government policies aimed at encouraging foreign expansion. These drivers vary and impact differently on companies, depending on their competitive situation, motives and choices.

Some firms may be in a position to directly respond to these internationalisation pressures or opportunities by utilising competitive advantages which they possess in order to compete with firms in overseas markets, as mentioned in the previous section. TNCs which expand overseas on this basis are referred to as “asset exploiting” in figure 7, and its choice of host country location is determined by one or more of three types of motive: market seeking, efficiency (cost reduction) seeking, and resources seeking (for factor inputs such as skilled labour, raw materials or good quality infrastructure). The specific host country locations chosen will also be influenced by contingent factors, such as the strength of local competition, the availability of partners, ethnic ties and government inducements prevailing in host economies; but overall the company will choose locations aimed at minimising costs and maximising its objectives. Lall’s conception of developing country TNC strategy is almost exclusively about asset exploitation FDI, in line with the general academic tenor when he was writing.5

In contrast to asset exploiting TNCs, firms pursuing asset augmenting FDI may not possess significant competitive advantages allowing them to respond effectively to the drivers mentioned above. In order to address this shortcoming, such firms are therefore motivated to venture into international markets in order to buy “strategic” created assets such as brands, distribution networks or R&D facilities. In a world economy characterised by high levels of international competition and rapid technological advance, firm-specific advantages are fragile and can easily erode. Asset augmenting FDI has therefore become more common and firms must develop organizational capabilities which facilitate the internalisation of new assets, as well as the absorption of learning in their internationalisation process. Apart from an occasional nod in this direction, Lall does not consider this as a major motive or strategy for TWMs at the time he was writing, possibly because at that time virtually all developing country FDI was South-South, with very little being South-North. However, he did argue,

“…a new form of overseas investment…is also expected to grow in the future: the taking of equity shares in some high technology firms in developed countries in order to obtain access to their technology. Hong Kong, Taiwan and Korea have already undertaken investments of this sort…” (Lall 1983a)

5 As amply demonstrated in his chapters in Lall (1983b), for example, p15 he argues the asset exploiting nature of TWMs; p59 he refers to the technological advantages of Indian TNCs, which are exploited by FDI; similarly again on p261-262.
WIR 06’s findings are that both asset exploiting and asset augmenting are important components of developing country motives and strategies, especially because South-North FDI is increasingly common. The three case studies above illustrate the importance of two types of asset exploiting strategy – i.e. “market-seeking” FDI (Hikma has hitherto focussed mostly on regional markets, while Marcopolo has aimed for niche markets across the South), and “efficiency-seeking” FDI (all three companies gain cost advantages by producing in other developing countries) – as well as “created-asset seeking” (all three companies rely on specialist knowledge and expertise, which sometimes needs to be obtained from developed countries.) Overall, market seeking is the preponderant motive for developing country TNCs (as with developed country TNCs). In addition, natural resources seeking strategies are also common in South-South FDI, especially because of the burgeoning economic expansion of giant developing economies such as China and India. The best illustrations of this are the large-scale investment projects initiated by Chinese companies in the South, from Latin America to Africa and Central Asia.

Having said all this, internationalisation to either exploit or augment of assets does not necessarily result in foreign direct investment; and firms can choose a number of other responses to the drivers to internationalisation. Figure 7 also shows some common alternatives to FDI for both types of strategy. For example, a firm does not need to invest overseas in order to exploit its advantages. It can continue to produce domestically and export
to overseas markets (thereby realising scale economies, among other benefits). The situation is similar for asset augmenting internationalisation. Firms’ alternatives to FDI (on the bottom-right of figure 7) include a domestic creation of assets (through R&D for example), the licensing of knowledge from other firms (including foreign ones, a technique much used by Korean and Japanese firms in the past), and establishing joint ventures in the home economy with foreign TNCs. These alternatives are, in essence, the creation of technological and other capabilities in the context of a national development policy.

At a time when asset augmenting FDI was seldom considered even by developed country TNCs (and would have been difficult to conduct – e.g. because of host country regulations – or manage – e.g. because information technologies were still at a fledgling stage), the above alternatives were generally the more viable way for firms to augment assets. Moreover, for a public-spirited Lall, such development strategies were more valuable for countries as a whole, than OFDI-based asset augmentation by the odd TNC (which might, in any case, thereby become “detached” from its home economy). This is pure speculation, of course, because ‘third world multinationals’ were always only one string to Lall’s bow – but given that after the mid-1980s his work on TWMs dwindled to near zero, it would be nice to consider that insights from this earlier work led directly to the particular line of research he later chose to pursue. Furthermore, one might also speculate that if fate had not decreed it otherwise, he would at this very moment be returning to pursue the study of developing country TNCS.

**Conclusion**

Sanjaya Lall’s research and publications on Third World Multinationals was prodigious and much of it still relevant and resonant today. Those of us who now see far, do so because we stand on the shoulders of giants such as Sanjaya Lall.

Those broad shoulders would have been advantageous to us last year as we researched and wrote WIR 06. Lall’s earliest work on Third World Multinationals did not focus greatly on the development impact of these companies on either home or host countries (though he did argue that a high level of multinationality was not necessarily a “good thing”, Lall 1982). In later years he alluded more to it, but in a broader context. This specific issue was very much to the fore in WIR 06, especially because of the proportionally greater share of developing country TNCs in the South. His inputs and insights would have been invaluable. For UNCTAD, the rise and impact of South-South FDI will remain a prime focus of our work in the foreseeable future. Sanjaya Lall would have appreciated this.

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6 Even where overseas production becomes essential, a firm might choose to license its advantages to a foreign company, which then establishes production or service facilities and pays the licensor a royalty. If a firm decides to opt for FDI by internalising markets in products or knowledge (i.e. conduct operations itself) the reasons are usually associated with market imperfections (e.g. different valuations of assets by a licensor and licensee because information is imperfect).